



# Ontario Energy Board Commission de l'énergie de l'Ontario

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## DECISION AND ORDER

EB-2014-0116

## TORONTO HYDRO-ELECTRIC SYSTEM LIMITED

Application for electricity distribution rates effective from May 1, 2015 and for each following year effective January 1 through to December 31, 2019

**BEFORE: Christine Long**  
Presiding Member

**Ken Quesnelle**  
Vice Chair and Member

**Cathy Spoel**  
Member

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December 29, 2015

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## 1 INTRODUCTION AND SUMMARY

This is a Decision of the Ontario Energy Board (OEB) in response to an Application by Toronto Hydro-Electric System Limited (Toronto Hydro) for permission to charge certain distribution rates to its customers.

Toronto Hydro is an electricity distributor licensed by the OEB which provides electricity to the City of Toronto and serves approximately 730,000 customer accounts. Toronto Hydro's distribution system consists of distribution lines, poles and equipment, distributing approximately 18 percent of the electricity consumed in the province of Ontario. Toronto Hydro is a wholly-owned subsidiary of Toronto Hydro Corporation (THC), whose sole shareholder is the City of Toronto.

Toronto Hydro has applied for distribution rates for the years 2015 to 2019. The OEB allows distributors to propose a "custom" application which addresses the unique circumstances that their utility will face over the next five years (Custom IR).

Toronto Hydro has filed a Custom IR on the basis that it is required to spend a large amount on capital replacement and upgrades. In order to be able to minimize the amount of the annual bill impact on customers and to be able to complete the sheer volume of work required, Toronto Hydro has proposed a paced strategy which spreads the capital work over an extended period of time.

Intervenor groups participating in the Application process generally oppose the levels of spending proposed by Toronto Hydro for both capital and operating expenses. These groups argue that Toronto Hydro could be more efficient and does not need to undertake the volume of capital projects it proposes within the timeframe contemplated. Projects that the intervenors concede are necessary could be completed for a lower cost.

The OEB's job is to determine distribution rates that are just and reasonable. In doing so, the OEB must balance the needs of customers and the utility.

The OEB is approving capital spending which will allow Toronto Hydro to proceed with some of the proposed upgrades to its capital infrastructure. While the OEB understands the position taken by the utility, the OEB is not granting Toronto Hydro the entire amount it seeks to spend on capital. The OEB is of the view that efficiencies could be realized which would reduce the amount necessary to complete capital projects. The OEB also is of the view that reductions could be made to Toronto Hydro's proposed operations and maintenance budgets.

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The record in this case is one of the largest that the OEB has ever seen. It is important to strike a balance between the amount of evidence necessary to evaluate the Application and the goal of striving for regulatory efficiency. It is important to note that it is not the OEB's role, nor the intervenors, to manage the utility or substitute their judgment in place of the applicant's management. That is the job of the utility. The OEB has established a renewed regulatory framework for electricity (RRFE) which places a greater emphasis on outcomes and less of an emphasis on a review of individual line items in an application. It is on the basis of outcomes that the OEB has reviewed the Application and come to its Decision.

Key Decision Points are listed below.

- Toronto Hydro's rates will be set on a 5 year Custom IR basis.
- Toronto Hydro's rate framework is structured in such a way as to support the achievement of RRFE objectives
- - The 2015 base OM&A increase should be 2.1%, approximately the rate of inflation over the 2014 actual spending, providing a base OM&A of \$246 million.
- Toronto Hydro's proposed capital budget will be reduced by 10% annually
- The C-factor mechanism for capital recovery in the 2016 to 2019 period is accepted subject to certain modifications
- An earnings sharing mechanism (ESM) as proposed by Toronto Hydro is accepted. The ESM will be symmetrical and incorporate a 100 basis point dead band. Earnings in excess of the 100 basis point dead band are to be split on a 50:50 basis with ratepayers.
- The proposal regarding the transfer of street lighting assets and Toronto Hydro's load forecast are approved

The OEB will allow Toronto Hydro to implement rate and fiscal year synchronization effective January 1, 2016. Rates will be effective May 1, 2015.

While Toronto Hydro will provide more accurate bill impacts with its draft rate order filing, the OEB approximates that this Decision will increase the distribution portion of the bill by 5%.

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## 2 ORGANIZATION OF THE DECISION

As summarized above, the OEB has determined that it will approve rates for the 2015 to 2019 period using the Custom IR framework proposed by Toronto Hydro with the modifications outlined in this Decision.

The OEB has organized this Decision into chapters, reflecting the issues that the OEB has considered in making its findings. Each chapter covers the OEB's reasons for approving or denying certain aspects of the Application in the form requested and its determinations on what level of spending is allowed in the calculation of Toronto Hydro's rates using the Custom IR methodology.

The initial chapter provides the OEB's views as to the extent to which Toronto Hydro's Application conforms to the RRFE policy and why the OEB believes this to be the case.

Subsequent chapters deal with the proposed work plans of Toronto Hydro in terms of operations and maintenance spending as well as its capital spending and how it developed its capital spending plan as well as its proposal for a C-factor capital recovery mechanism.

Matters dealing with the development of the rates themselves are covered in chapters dealing with revenue requirement (which incorporates the results of the budgets for capital and operations and maintenance, cost of capital, depreciation, etc.) load forecast, cost allocation and rate design

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## 3 DECISION ON ISSUES

### 3.1 The OEB's Renewed Regulatory Framework for Electricity (RRFE) (Issue 2.1)

The OEB must consider whether Toronto Hydro's proposed Custom IR approach provides an appropriate framework for rate-setting in light of Toronto Hydro's capital needs and operating circumstances and the OEB's policies as set out in the RRFE.

The OEB assesses rate applications within the context of the RRFE, a new policy framework it adopted in 2012. Toronto Hydro has applied for a Custom IR for 2015-2019, one of the options available to it under the RRFE.

Throughout this Decision the OEB makes findings and observations on the objectives and implementation of the RRFE in the context of Toronto Hydro's Application. These are summarized here in order to assist all interested parties to understand the OEB's approach to the RRFE.

The OEB intends to provide guidance to distributors who have yet to file applications, which will provide an opportunity for the OEB to articulate its views as the industry evolves in response to the RRFE, as regulatory predictability is a necessary component of an effective regulatory framework.

This section of the Decision addresses the extent to which Toronto Hydro's Application conforms to the RRFE and is likely to achieve its objectives.

The OEB does not decide whether the option chosen by the applicant is the most appropriate. The OEB decides rather whether the proposal contains features that can be relied on to achieve the RRFE objectives. The Custom IR is described in the RRFE as a suitable choice for distributors with large or highly variable capital requirements. However, this is an example, not a condition precedent, and the OEB will not make a decision as to whether it is the best option for any particular distributor. The custom option in the policy allows for proposals that are tailored to a distributor's needs as well as for innovative proposals intended to align customer and distributor interests.

At the heart of the RRFE policy objectives are customer-focused outcomes and continuous performance improvement by distributors. The policy reflects the OEB's view that these outcomes are most likely to be achieved when the service interests of customers and the business interests of distributors are aligned.

This alignment will only be achieved through an ongoing effort by distributors to engage customers in a way that provides useful input into the development of their business

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plans. The process should educate customers and distributors of each other's issues and priorities. Distributors should develop plans that respond to customer service needs.

This alignment also requires that distributors be financially rewarded for successful performance. This shifts the focus of regulatory review from strictly an examination of the reasonableness of costs to measuring and monitoring performance indicators as they relate to the value of services received by customers.

A Custom IR, unlike other rate setting options in the RRFE, does not include a predetermined formulaic approach to annual rate adjustments, it does not automatically trigger a financial incentive for distributors to strive for continuous improvement. The OEB expects that Custom IR applications will include features that create these incentives in the context of the distributor's particular business environment.<sup>1</sup>

In this proceeding, a variety of views were advanced as to whether Toronto Hydro's Application adequately meets the expectations of the RRFE. Some parties agreed with Toronto Hydro that its proposal complies with the RRFE and all related OEB guidance, while others urged the OEB to deny Toronto Hydro's 5 year Custom IR and set rates on a two year cost of service basis.

Particular concerns were raised about benchmarking and customer engagement.

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<sup>1</sup> The OEB recently provided a decision on a Hydro One Custom rate application. The OEB determined that Hydro One's proposal was not likely to achieve the RRFE policy objectives. Instead, the OEB approved rates on a three year cost of service framework basis. It did so to allow for necessary program spending and to allow the time necessary for Hydro One to develop features intended to achieve the RRFE policy objectives.

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## Findings

Toronto Hydro's rate framework proposal incorporates features that are aligned with the RRFE's objectives. Toronto Hydro will be incented to achieve improved performance over the life of the plan. Its "C factor" method of funding its capital plan is intended to correspond to its capital program execution over the life of the plan and is a customized solution to its business needs. The OEB has determined that Toronto Hydro's rates will be set on a 5 year Custom IR basis. The OEB accepts that Toronto Hydro's rate framework is structured so as to support the achievement of RRFE objectives but, as discussed later in the Decision, finds that Toronto Hydro's evidence does not fully support its proposed spending levels.

The OEB has determined that it cannot fully rely on Toronto Hydro's approach to establishing its spending proposals in determining if the outcome of that spending is desirable for ratepayers. It is not clear that Toronto Hydro's proposals are necessarily aligned with the interests of its customers, as they are largely supported by an asset condition analysis rather than the impact of the proposed work on the reliability of the system. The approach used by Toronto Hydro does not give a clear indication of how the overall spending is related to customer experience such as reliability.

The Application lacks evidence of corporate policy guiding Toronto Hydro staff to focus on impacts on customers when developing spending proposals. The focus overall is on the need for work based on asset condition assessment without a clear understanding of the results expected to be achieved through the work. Continuous improvement measurements are lacking, as discussed in the section of the Decision dealing with reporting requirements.

There does not appear to be any measurement of units of activity and their costs that would allow for year over year assessment of improvement in Toronto Hydro's proposed metrics. The OEB agrees with the parties which suggested that reporting measures such as specific performance improvements sought and achieved per asset class, tie-ins of capital program spending to the dollar value of OM&A savings achieved and how program spending specifically impacts the reliability and quality of service are desirable under the RRFE. However, as the RRFE is relatively new, the OEB does not expect all such measures to be implemented at once.

Toronto Hydro does not monitor whether or not it has optimized the manner in which it tenders the work but instead relies heavily on the fact that it goes to market to perform over 80%<sup>2</sup> of its work. It has no comparisons of a holistic project RFP approach versus

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<sup>2</sup> Argument In Chief Compendium Tab 1 Table of Contents, p.1 and discussed in Transcript, Volume 4, p. 87 L23 to p.88 L17,

its unit of work approach. There are no tangible performance enhancement programs with its service providers.

In the absence of these parameters, Toronto Hydro's rates have been set based on the OEB's assessment of Toronto Hydro's historic expenditures, and the OEB's expectations with respect to improved productivity informed by the external benchmarking evidence of the expert witnesses for OEB staff and Toronto Hydro. The effect of these determinations is provided in subsequent sections.

## **3.2 Customer Engagement and Outcomes (Issues 2.1 and 2.3)**

### **Background**

Toronto Hydro's Application stated that it had undertaken two levels of customer engagement:

- i. ordinary course, day-to-day engagement with its residential, non-residential and very large customers, and
- ii. customer engagement activities undertaken specifically in connection with the Application.

Many intervenors argued that Toronto Hydro's customer engagement efforts were inadequate in producing acceptable outcomes for existing and future customers. They argued that the activities undertaken were inadequate to meet the OEB's requirements for two reasons: (i) customers had not been provided with enough information to understand the impact of proposed levels of work on their rates and (ii) Toronto Hydro did not adequately demonstrate how what was heard from its customers was reflected in the Application. Several intervenors questioned Toronto Hydro's conclusion from its customer engagement activities that a majority of its customers accept the need for the proposed rate increases and expressed concerns about the process used to reach this conclusion. These concerns included the reliability of the survey, the lack of context in the way spending proposals were put to customers, and the fact the results were too late to have any meaningful influence on the capital and operating plans.

Toronto Hydro argued that their plans are consistent with customers' views expressed during its customer engagement exercises.

### **Findings**

The OEB finds that Toronto Hydro's customer engagement efforts undertaken as part of the Application are reasonable as the first such effort in the context of the RRFE.



The OM&A expenses since the last rebasing in 2011 have been fairly flat as can be seen in the above table.

The breakdown of spending on program areas was not available for 2014 actuals at the time of the hearing, so comparisons are with the 2013 actual expenses.

The main drivers of the requested increase are preventative and predictive maintenance (57% over 2013), corrective maintenance (31% over 2013), customer care (16% over 2013), information technology and facilities management. The only significant decrease is in emergency response which was anomalously high in 2013 due to the ice storm in December of that year.

The intervenors and OEB staff raised the following main issues about the OM&A budget:

1. The increase in the 2015 base is excessive given historical levels of spending and does not adequately reflect customers' ability to pay
2. The OM&A budget does not reflect reductions in maintenance that would be expected with increased capital spending on system renewal
3. Toronto Hydro did not prepare 5 years of OM&A budgets
4. Should Toronto Hydro be required to give ratepayers the IRM benefit of restructuring in 2012?

As well, the proposed treatment of certain specific budget items was questioned:

1. Regulatory costs
2. Sharing of savings due to ERP in later years of the plan
3. Accounting methodology for OPEBs (Other Post-Employment Benefits)

### **3.3.1 The Base Level of OM&A**

Toronto Hydro described its budgeting process as "top down/bottom up". In oral evidence, the Toronto Hydro witness explained the process:

The instructions were provided by the executive that the departments should come forward with their 2015 needs, as those needs would persist for five years, and exercise some constraint before requesting increases, but where increases were requested over current levels ...be prepared to justify those increases.<sup>3</sup>

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<sup>3</sup> Transcript, Vol. 9, p.20 L16-22

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No specific target was given, except that it would be preferable to keep the OM&A envelope from 2015 onwards at inflation.

The witness further went on to say:

...the top-down instruction was to put forward what the expert in those areas believe is required and to exercise some constraint in doing so, and there was that iterative exercise with those requests coming in and reviewing those requests as a whole, and considering factors such as functional requirements, customer service and rate impacts,...and balancing, again, those customer needs against things like customer impacts such as rate impacts ...<sup>4</sup>

From 2011 to 2014 the actual spending by Toronto Hydro on OM&A was essentially flat. While the test year budget for 2014 was \$246.6 million, the actual spend was \$241.2 million. Notably, several of the program areas for which large increases have been requested for 2015 were actually underspent in 2014. For example, preventive and predictive maintenance (\$14.9 million actual whereas \$16.1 million was budgeted), corrective maintenance (\$17.6 million actual whereas \$19 million was budgeted) and customer care (\$40.6 million actual whereas \$42.2 million was budgeted).

In the absence of compelling evidence as to the reasons for the spending levels in 2014, the inference drawn by the OEB is that this is the level of spending reasonably required by Toronto Hydro to maintain and operate its system.

The OEB expects that the benefits of Toronto Hydro's IRM from 2011 to 2014 will persist for ratepayers into the next rate cycle. Toronto Hydro's request for an OM&A budget for 2015 of \$269.5 million is an 11.7% increase over its actual spending in 2014. Given Toronto Hydro's evident ability to operate for the last 4 years with very modest increases, the OEB finds that a 2015 base OM&A increase should be 2.1%, approximately the rate of inflation over the 2014 actual spending. This provides a base OM&A spending level of \$246 million.

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<sup>4</sup> Transcript, Vol. 9, p. 21 L8 -17.

### 3.3.2 Relationship between OM&A and Capital Spending

Toronto Hydro argued that OM&A does not decrease with increased spending on capital system renewal, hence the large requested increases in the maintenance program areas.

While the OEB recognizes that the relationship between capital spending and OM&A is complex, the OEB finds that it is reasonable to expect that there will be some reductions in OM&A costs, particularly those related to maintenance, from the large capital expenditures, over many years, on system renewal, general plant, and system service. New assets should require less maintenance than old assets (at least in the corrective maintenance category) and underground assets should require less maintenance than overhead assets as there is no need for vegetation management, and no issue of animal interference.

Toronto Hydro's own evidence suggests that given the historical record, there should be less maintenance required with newer assets. The Toronto Hydro witness said in oral evidence:

...when I started at the Hydro, we used to have our crews organized in a group called construction and maintenance, and the reason we did that is their normal job would be to do capital construction, and they would be called away periodically if there was a reactive requirement, if something failed and it needed to be replaced, and then they would go back to their capital work.

Today, we have two departments and 13 full-time crews that do nothing but replacement of failing assets, and that's because of this age-related problem.<sup>5</sup>

The OEB finds that as aging assets are replaced the extent to which the system requires reactive maintenance should be reduced. Most of Toronto Hydro's capital spending is on system upgrades and renewal rather than expansion of the system, so new assets are replacing old ones that require corrective maintenance in addition to routine inspections and preventive maintenance. The OEB agrees with Toronto Hydro that the need for inspections and routine maintenance will continue with new assets, but the expensive corrective maintenance and the unplanned reactive maintenance should reduce over time if the system is well managed. None of these relative costs are reflected in Toronto Hydro's OM&A budget. However, the OEB will not reduce the OM&A budget from that spent over the last few years as it recognizes that some of the

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<sup>5</sup> Transcript, Vol. 6, p. 67, L12-L22.

assets not replaced will continue to require extensive maintenance, and that system renewal is a gradual process.

### **3.3.3 Are 5 years of OM&A forecast required?**

The OEB agrees with Toronto Hydro and some of the intervenors that Toronto Hydro is not required to prepare a forecast of five years of OM&A budgets to comply with the RRFE for a Custom IR application. This would essentially result in a five year cost of service application, rather than an incentive ratemaking scheme. The OEB will expect Toronto Hydro to manage within the OM&A envelope adjusted annually by the incentive factor for the five year period of the plan addressed later in this Decision..

### **3.3.4 Sharing Benefits of IRM restructuring**

The OEB does not agree with intervenors that the restructuring savings incurred by Toronto Hydro during the IRM period should be shared beyond their persistence in a lower base OM&A. This would be counter to the principles of an IRM regime. The OEB recognizes that Toronto Hydro has restructured, which undoubtedly contributed to its ability to manage with essentially flat OM&A spending from 2011 to 2014. Toronto Hydro did incur real costs to restructure, from which the ratepayers will benefit going forward.

### **3.3.5 Regulatory Costs**

There are several issues related to the recovery of regulatory costs. Toronto Hydro seeks recovery of the full costs of preparing the Application, spread out over the 5 years of the Custom IR period. Some of these costs were incurred and paid by Toronto Hydro in prior years, so the first issue is whether these can and should be recovered in 2015 and going forward. Some of the intervenors also argue that the costs are excessive and some portion should be disallowed. Finally, Toronto Hydro has also requested recovery of its costs related to the wireless forbearance application as it is for the benefit of ratepayers. These costs were also substantially incurred in prior years.

The OEB agrees with Toronto Hydro that the regulatory costs of the Application can and should be recovered over the 5 year Custom IR period. This is consistent with the OEB's usual practice, and is the reasonable way for Toronto Hydro to recover those costs. Preparation of an application often spans more than one rate year.

The OEB also does not agree that any part of the costs of the Application should be disallowed. Toronto Hydro is larger and has more complex issues than most if not all distributors in Ontario, and the Application involves billions of dollars of spending. The RRFE requires distributors to prepare and support their applications, particularly Custom IRs, in a very thorough way. The OEB finds that the level of background work

undertaken by Toronto Hydro prior to preparing its Application was reasonable and appropriate given its circumstances. The fact that some of this work may not ultimately be filed in support of the Application does not mean that it was not useful in helping Toronto Hydro to refine its plans. .

While Toronto Hydro is correct that the Wireless Forbearance Application does benefit ratepayers, to the extent that funds were spent in 2014, the OEB will not allow them to be recovered in 2015. The appropriate way to recover these costs in a subsequent year would have been to request a deferral account in the year the costs were incurred. The OEB does not consider these costs to be part of this Application.

### **3.3.6 Enterprise Resource Planning (ERP) Savings**

The ERP will be implemented in 2016 and savings are expected from the efficiencies that will result starting in 2017 or 2018. Some intervenors requested that the OEB deviate from its usual approach and require Toronto Hydro to adjust its OM&A budget to account for these savings in later years of the Custom IR.

Toronto Hydro proposed an 11.7% increase in OM&A spending over its 2014 actual spending level. The OEB has approved a 2.1% increase recognizing the historic spending levels. The OEB notes that Toronto Hydro will have to find efficiencies to accomplish the required OM&A and will therefore not require further reductions specifically to account for any savings resulting from the introduction of the ERP.

### **3.3.7 Other Post-Employment Benefits (OPEBs)**

OEB staff and some intervenors requested that the OEB require Toronto Hydro to account for OPEBs on a cash rather than accrual basis as the OEB did for Ontario Power Generation.<sup>6</sup>

The OEB will require Toronto Hydro to account for OPEBs on a cash rather than an accrual basis for ratemaking purposes. The OEB has initiated a generic consultation to deal with this issue. Given that the difference between the two accounting methods will be material for Toronto Hydro, the OEB is of the view that the most appropriate way to deal with this issue is to set rates on the cash basis for now and to establish a variance account which will track the difference between the forecast cash and forecast accrual methods pending the outcome of the generic consultation.. Toronto Hydro shall file a draft accounting order as part of its draft rate order filing and shall use a separate sub-account of account 1508.

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<sup>6</sup> EB-2013-0321, Ontario Power Generation, *Decision with Reasons*, November 20, 2014, p.88.

### 3.4 The Custom Framework Proposed by Toronto Hydro (Issue 2.2)

#### Background

The OEB must decide whether the proposed Custom formula proposed by Toronto Hydro is appropriate. Toronto Hydro has proposed that distribution rates in Years 2 through 5 be adjusted annually by using a custom Price Cap Index (PCI):

$$PCI = I - X + C$$

Where,

- “I” is the OEB’s inflation factor, determined annually
- “X” is the sum of:
  - The OEB’s productivity factor
  - Toronto Hydro’s custom stretch factor
- “C” provides incremental funds that are necessary to fund capital needs

Toronto Hydro has proposed two changes to the price cap mechanism that the OEB normally uses.

First, based on the benchmarking it has filed to support this Application, Toronto Hydro is proposing a stretch factor of 0.3%, rather than the 0.6% that would otherwise be applied by the OEB to Toronto Hydro. Second, Toronto Hydro has proposed the use of a custom capital “C” factor

#### 3.4.1 The Custom Stretch Factor

##### a) The Appropriate Stretch Factor

The OEB undertakes annual benchmarking for all Ontario distributors and based on those benchmarking results assigns each distributor a stretch factor. One of five possible stretch factors is assigned based on whether the distributor’s costs are above or below the benchmark. The “middle” stretch factor is 0.3% which represents an “average” performer. The stretch factor is part of the formula that is used to adjust a distributor’s rates. Based on the OEB’s current methodology, Toronto Hydro’s stretch factor is 0.6%. Toronto Hydro submitted benchmarking evidence in the form of Power System Engineering’s Econometric Benchmarking Report (the PSE Report). On the basis of this report, Toronto Hydro argues that it should be assigned a “better” stretch factor in the proposed Custom PCI framework of 0.3%. Toronto Hydro argued that

PSE's total cost benchmarking evidence demonstrates the reasonableness of its past and projected cost levels by demonstrating that Toronto Hydro is within +/- 10% of the benchmark which supports the assignment of the middle (0.3%) stretch factor.

OEB staff engaged Dr. Lawrence Kaufmann of the Pacific Economic Group (PEG) to analyze Toronto Hydro's proposed stretch factor and custom capital factor, to advise on Toronto Hydro's Application generally, and to assess the design of the Custom IR plan. PEG was also asked to evaluate the technical work of PSE and, where relevant, to provide alternate cost and reliability benchmarking evidence.

As a result of the annual benchmarking the OEB undertakes for all Ontario distributors, the OEB has detailed benchmarking evidence involving both costs and reliability for Toronto Hydro. Based on this benchmarking data, Toronto Hydro is classified as a high cost performer with a stretch factor of 0.6%. Parties argued that it would not be unreasonable for the OEB to continue to apply a stretch factor of 0.6%, and argued that Toronto Hydro has not justified why its current stretch factor of 0.6% is inappropriate.

Some parties argued for an even higher stretch factor. They proposed a stretch factor of 1.0%. OEB staff, based on Dr. Kaufman's evidence, took the position that the OEB should consider a higher stretch factor to, in effect adjust for the fact that Toronto Hydro was a relatively poor performer in prior years. OEB staff argued that one way to implement this would be to set a stretch factor for the term of this Custom IR plan that is higher than 0.6%. Most parties argued that a stretch factor between 0.6% and 1% would be appropriate. They also submitted that the benchmarking analysis demonstrates that Toronto Hydro's costs are significantly higher than other Ontario utilities and its US peers. They also argued that the 0.3% stretch factor proposed by Toronto Hydro does not incent productivity.

Toronto Hydro argued that adopting any stretch factor greater than 0.6% would be contrary to OEB policy and arbitrary.

## Findings

The appropriate stretch factor for Toronto Hydro is 0.6%. The OEB finds that the evidence as a whole is not sufficiently persuasive to support the change sought by Toronto Hydro.

The experts' evidence on benchmarking differs in three key areas;

1. The Urban core variable
2. Approach to CDM costs
3. Asset price inflation costs (capital cost escalation rate)

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The Board will address its conclusions in each of the three areas.

### 3.4.2 The Urban Core Variable

The primary difference between the two experts was whether an “urban core” variable exists and should be included in the statistical formula used for benchmarking. This formula incorporates a number of variables to account for differences in operating conditions from one utility to another. Toronto Hydro argued that the OEB is benchmarking Toronto Hydro against the wrong set of comparators. Toronto Hydro says that it is dissimilar to other Ontario utilities because these utilities do not have to operate in the dense urban core like Toronto Hydro must. Toronto Hydro retained PSE to undertake a benchmarking study which included comparisons to US utilities that operate in areas where there are dense urban cores. Toronto Hydro, supported by PSE’s study, argued that it is more costly to undertake distribution activities in an area where there is a dense urban core. PSE conducted benchmarking on this basis and determined that the results showed that Toronto Hydro’s costs were in line with the US utilities, which operated in a dense urban core.

While Toronto Hydro argued that the cost challenges of operating in an urban core are highly statistically significant, and need to be factored into the benchmarking model, Dr. Kaufman’s evidence substituted a dummy variable for the urban core and determined that the urban core variable was not statistically significant.

One of the difficulties the OEB has in assessing the expert evidence is the differences in the data used by PSE and PEG. PSE’s sample size was very small as they were only able to identify 4 utilities that served urban cores similar to Toronto’s and whose data is publicly available. PEG, on the other hand, had a much larger sample of 27 US cities. However, PEG’s sample included a number of cities such as Buffalo which do not seem to have the population or urban density that Toronto has. While the OEB agrees that the premise of an urban core variable warrants further investigation, it cannot determine that the evidence demonstrates that it exists. As well as the issues with sample size, it is not clear to the OEB how much of Toronto Hydro service area is part of the urban core, or what percentage of the capital projects proposed by Toronto Hydro will be undertaken within that area.

### 3.4.3 Cost Benchmarking

PSE’s analysis indicated that Toronto Hydro’s costs were 31.1% *below* the costs expected for an average electric utility operating under similar circumstances. On this basis, Toronto Hydro says that its costs are within +or- 10% of the benchmark and therefore it qualifies for a stretch factor of .03%. PEG concluded that Toronto Hydro’s costs were 9.7% *above* its expected costs and predicted the company’s costs to be

34.7% *above* its expected costs in 2019, the final year of the Custom IR plan. PEG characterizes Toronto Hydro as a sub-par performer<sup>7</sup> and recommends a stretch factor of between 0.6 and 1.0%.

The OEB is faced with conflicting expert evidence.

PEG takes issue with a number of measures used by PSE in the cost benchmarking. These include the following:

- PSE use of a more limited cost measure – (relying on Total Factor Productivity based cost measure)
- PSE use of a standardized treatment of certain costs in order to compare to US utilities
- PEG disagreed with PSE's use of business condition variables. PEG added a variable to control for high voltage assets owned by US utilities, and eliminated the urban core variable arguing that it was redundant, inappropriate in electricity distribution benchmarking and appears to distort the estimated impact of other business condition variables – especially undergrounding.

#### **3.4.4 CDM expenses**

The two experts took different approaches to account for CDM expenses. The issue arose as CDM expenses are reflected in the costs of the U.S. utility sample but not those of Toronto Hydro. PEG's approach was to eliminate customer service and information (CSI) expenses from the U.S. utility sample as CDM expenses account for the largest share of CSI costs. PSE's approach was to add CSI costs back to its U.S. cost measure, while also adding in Toronto Hydro's actual and projected CDM expenses.

#### **3.4.5 Asset Price Inflation Factor**

The PEG and PSE assessments also differed in their approaches to asset price inflation with PSE projecting a rate of 4.55%, while PEG considered a 2% annual growth rate to be more reasonable.

Several parties argued that PSE's asset price inflation factor is distorted by the anomalously high capital asset price inflation from 1973-1983 that was included in the calculation.

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<sup>7</sup> PEG Report, December 2014, p.55

The OEB considers the asset price inflation value used by PEG to be more appropriate. The 2.0% annual growth rate is more closely aligned to the value used by the OEB as the annual inflation factor.

### **Similarities between the Experts**

There were also areas where the experts agreed. While they disagreed on the rate of increase, both experts did agree that Toronto Hydro's costs are increasing at a faster pace than the US comparators'.

### **b) Application of the Stretch Factor to Capital**

Some parties argued that a stretch factor should be applied to capital as well as OM&A costs. They pointed out that the OEB has always applied stretch factors to total costs rather than just OM&A costs. Others did not favour this approach, and submitted that the capital budget should be reduced or it should be linked to performance metrics instead.

Toronto Hydro argued that the stretch factor should not be applied to capital (the C factor) as productivity is sufficiently embedded in Toronto Hydro's capital plan and the rate framework.

### **Findings**

The OEB has consistently applied stretch factors to total costs in order to incent productivity in both the areas of capital expenditure and OM&A. The OEB finds no compelling reason to depart from this approach. While the Application put forward by Toronto Hydro may be a custom application, one of the key aspects of the OEB's RRFE is the requirement to continue to make productivity improvements. As discussed later in this Decision, the OEB is concerned that the Application does not contain enough productivity incentives. Application of the stretch factor to the C factor is one way to remedy this deficiency.

### **The Use of Benchmarking**

SEC argued that custom benchmarking is a critical aspect of a Custom IR application and that any distributor seeking greater increases in revenue requirement or rate than the norm should be in a position to file benchmarking evidence consistent with those greater levels. If they cannot, their additional spending requirements cannot be supported.

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The OEB has emphasized in the RRFE<sup>8</sup> and in previous cases<sup>9</sup> the importance of benchmarking. It is an important input to the OEB's assessment of an application, but it is not the sole determining factor in setting rates. In the context of a Custom IR, the OEB will use benchmarking as a tool to inform its decisions, but will not use it as the method by which to determine rates.

## Findings

The OEB finds that a 0.6% stretch factor is appropriate. The stretch factor will apply to the C-factor, which will be discussed later in the Decision. The OEB is not convinced, based on the evidence provided, that there is any reason to deviate from the stretch factor applied to Toronto Hydro, as a result of the OEB's annual benchmarking.

### **3.5 The Distribution System Plan (DSP): Capital Programs and expenditures for the 2015-2019 period (Issue 3.2)**

#### Background

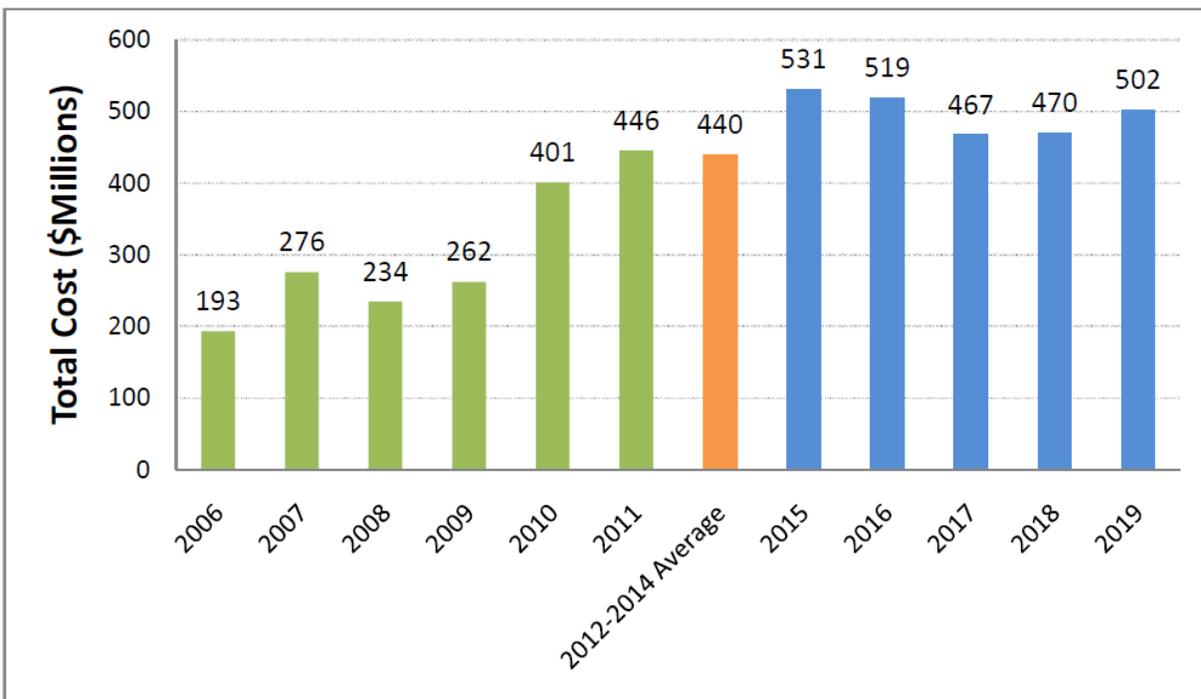
Toronto Hydro has stated that this custom Application is driven by a significant capital program. Toronto Hydro's historic and forecast capital spending in the 2006 to 2019 period is summarized in the figure below which is reproduced from its evidence<sup>10</sup>:

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<sup>8</sup> Ontario Energy Board *Report of the Board Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach*, October 18, 2012, pp. 59-60

<sup>9</sup> EB-2013-0416/EB-2014-0247, p. 15.

<sup>10</sup> EB-2014-0116 Application E 1B/T2/S4/p. 6 Filed 2014 Jul 31 Corrected 2015 Feb 6



These expenditures total just under \$2.5 billion for the five-year period of the DSP.

Toronto Hydro stated that it was confident that it can execute the proposed capital plan arguing that its successful delivery of the 2012-2014 ICM program is the best evidence of its ability to deliver a capital program of the size and complexity contained in the Application. It stated that it is proposing four specific measures to track and evaluate cost efficiency of executing its DSP: (a) Engineering, Design and Support Costs, (b) Materials Handling on-Cost, (c) Contractor Cost Efficiency and (d) Asset Assemblies Framework.

Productivity outcomes will be shared with customers throughout the duration of the plan in the form of more cost-effective assets being placed into service and reinvestment into the system.

Toronto Hydro stated that it considers age, condition, customer impacts and other asset-specific information in its capital planning.

Intervenors and OEB staff generally argued that Toronto Hydro had not adequately supported a \$2.5 billion capital plan.

Their objections included:

- Inadequate evidence of the need and prioritization of the proposed programs

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- Reliability and outage trends do not support the capital investment levels proposed in the Application, as Toronto Hydro's evidence showed an improvement in reliability during a period in which Toronto Hydro was spending considerably less than proposed for the next five years.
  - Rate impacts on customers
  - Assets proposed for replacement are not aligned with the recent results of Toronto Hydro's asset condition assessments.

Intervenors also submitted that the OEB should require Toronto Hydro to undertake various studies and/or filings related to the implementation of the DSP during the Custom IR period.

Toronto Hydro took the position that the objections of the intervenors were not supported by the evidence and were based on the mistaken assumptions that Toronto Hydro has moved from condition based to age based planning and that using asset age in planning leads to premature replacements.

There was no consensus amongst OEB staff and intervenors as to an appropriate level of spending. Suggested levels ranged from \$400 million to about \$480 or \$490 million per annum. Some intervenors argued that there should be much reduced spending on system renewal. SEC argued that, the OEB should significantly reduce Toronto Hydro's proposed capital plan and apply a productivity formula to the capital budget.

Toronto Hydro argued that due to the integrated nature of the DSP, it is not practical from a project management or work execution perspective to arbitrarily reduce spending in various categories or programs and an overall reduction in approved capital expenditures would require a re-evaluation of the capital plan.

Toronto Hydro also submitted that there is no simple correlation between system-wide reliability and total expenditures and the relationship is much more complex and nuanced.

## **Findings**

The OEB will not accept the capital budget as requested by Toronto Hydro. An annual reduction of 10% to the proposed capital spending is required.

Toronto Hydro presented three possible approaches to its DSP capital spending.

1. The Economically Optimal Approach – Capital spend of \$2.560B in the first year
2. The Accelerated 5 year Pacing – Capital spend of \$840M for two years, \$830M for the next three
3. The Paced Approach – the Application filed with the OEB.

Toronto Hydro's evidence did not include a full slate of reasonable funding requests as set out in the Economically Optimal Approach. Instead it chose the "Paced Approach" in order to balance operational and customer needs with consideration of rate impacts. The proposed Paced Approach contemplates capital spend of an average of \$498M per year over the plan period. Toronto Hydro states that this is the "minimal level of investment that is appropriate given the magnitude of the asset backlog and other critical system issues and operational needs that the utility faces."<sup>11</sup> The OEB disagrees.

As a general principle, the OEB accepts that the DSP represents a comprehensive approach to capital planning by Toronto Hydro over the next five years. Generally, the OEB does not take issue with the content of the DSP. The OEB's concerns in respect of the approach proposed by Toronto Hydro fall into two categories;

1. Asset Replacement Rate
2. Productivity Improvements

### **Asset Replacement Rate**

Toronto Hydro's proposal is largely supported by an asset condition analysis as opposed to a reliability impact assessment. Choices about spending are driven by assets, rather than based on services. Toronto Hydro considers the reliability impact to be an outfall of its asset replacement program.<sup>12</sup> The optimization tool, while very useful in providing the economic analysis of when to change out a particular asset does not give a clear indication of how the overall spend is directly correlated to the customer experience.

Toronto Hydro states that its response to manage the renewal of the backlog of end-of-life useful assets is guided by a lifecycle cost reduction policy. Toronto Hydro says that it can minimize costs, including customer interruption costs by replacing assets at the economic end of life.<sup>13</sup> Toronto Hydro defines an asset's economic end-of-life as being when the total life cycle cost, defined as the sum of the annualized risk cost and the annualized capital cost, is at its lowest. This is considered to be the optimal intervention time. The annualized risk cost which increases as the asset ages, represents the quantifiable costs of asset failure (including customer interruption costs) multiplied by the probability of failure. The annualized capital cost, which decreases as the asset ages, represents the capital cost of replacement, annualized over the asset's life.

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<sup>11</sup> EB-2014-0116 Toronto Hydro-Electric System Limited *Argument in Chief Compendium*, p. 19.

<sup>12</sup> Transcript, Vol. 9, p. 189, L 4-7.

<sup>13</sup> EB-2014-0116 Toronto Hydro-Electric System Limited *Custom Incentive Rate-setting Application for 2015-2019 Electricity Distribution Rates and Charges*, July 31, 2014, E 2B, S D3.

Several parties raised the concern that assets were being replaced too soon and that asset age was driving system renewal. Currently 26% of Toronto Hydro assets are beyond their useful lives. Despite a push on asset renewal since 2011, 26% is an increase from 22% beyond useful lives in 2011. Toronto Hydro explained that 33% of its assets will be beyond their useful lives by the end of the 5 year plan if the utility does not take a proactive approach and allows the assets run to failure. Toronto Hydro's objective is to reduce the backlog so that it can achieve a "steady state" where the percentage of assets beyond useful lives does not increase.

Toronto Hydro's evidence shows the following:

Year	% Assets not at end of life	% Assets past end of life	% Assets to reach end of life by 2020
2011	71	22	7 (between 2011-2016)
2015	67	26	7

Toronto Hydro argues that the useful life of an asset is the mid-point between the Kinectrics Minimum Useful Life and Maximum Useful Life for a specific asset type. By definition, assets that are approaching or have surpassed this mid-point have reached an age when a majority of those assets typically fail and when the statistical probability of failure increases exponentially every year.<sup>14</sup> This leads to a higher cost to repair and replace than asset renewal. Toronto Hydro states that the Asset Condition Assessment Audit carried out by Kinectrics in 2014 shows a significant decline in the health of the system. Intervenors questioned whether this additional cost of later replacement was borne out by the evidence.

The OEB shares the concerns of the parties that the age of the assets may be too heavily weighted in the determination of end of useful life. Toronto Hydro concedes that age of the asset is the primary driver with respect to asset replacement. Toronto Hydro also states that asset condition does factor into the decisions they make in respect of asset replacement.

SEC drew the OEB's attention to Toronto Hydro's single largest program its Underground Circuit Renewal Program (E6.1). This program seeks to replace underground switches, transformers and cable at a cost of \$459.3 over the five year term. Toronto Hydro plans to replace 1,667 underground transformers over the 5 years.

<sup>14</sup>Kinectrics report, p.9 of 29 of AIC

348 are scheduled to be replaced in 2015 alone. However the Asset Condition Assessment conducted by Kinectrics shows that in 2014 only 33 underground transformers are in poor or very poor condition, as show in the table below.<sup>15</sup> This is only one example, but it demonstrates the OEB's concern that there is too heavy an emphasis placed on asset age, rather than asset condition.

	Asset	% very poor	% poor	% fair	% good	% very good	% very poor & poor	# very poor	# poor	# fair	# good	# very good	# very poor & poor
1	Station Power	1.24%	13.64%	49.59%	23.14%	12.40%	14.88%	3	37	133	62	33	40
2	Station Switchgear	4.84%	36.69%	33.47%	9.27%	15.73%	41.53%	14	102	93	26	44	116
3	Air Blast Circuit	0.00%	3.89%	87.78%	2.78%	5.56%	3.89%	0	11	255	8	16	11
4	Air Magnetic Circuit	0.21%	4.72%	74.25%	18.88%	1.93%	4.93%	1	30	466	118	12	31
5	Oil Circuit Breakers	0.64%	10.19%	82.80%	6.37%	0.00%	10.83%	2	34	275	21	0	36
6	Oil KSO Breakers	0.00%	4.55%	81.82%	13.64%	0.00%	4.55%	0	3	48	8	0	3
7	SF6 Circuit Breaker	0.00%	0.00%	7.69%	46.15%	46.15%	0.00%	0	0	15	93	93	0
8	Vacuum Circuit	0.00%	0.21%	3.14%	10.25%	86.40%	0.21%	0	1	21	69	583	1
9	Submersible	0.00%	0.02%	6.68%	34.93%	58.36%	0.02%	0	2	638	3337	5576	2
10	Vault Transformers	0.00%	0.23%	23.48%	39.80%	36.50%	0.23%	0	30	3060	5188	4757	30
11	Padmounted	0.00%	0.02%	10.09%	43.51%	46.38%	0.02%	0	1	722	3115	3321	1
12	Padmounted Switches	0.00%	0.39%	7.20%	36.12%	56.30%	0.39%	0	3	58	290	452	3
13	3 Phase O/H Gang	0.00%	0.39%	3.01%	63.84%	33.15%	0.39%	0	4	33	707	367	4
14	3 Phase O/H Gang	0.00%	0.00%	15.38%	76.92%	7.69%	0.00%	0	0	2	12	1	0
15	SCADAMATE Switches	0.13%	0.00%	1.14%	57.34%	41.39%	0.13%	1	0	11	531	383	1
16	Wood Poles	2.34%	7.64%	44.13%	7.28%	38.61%	9.98%	2885	9419	54403	8975	47598	12303
17	Automatic Transfer	0.00%	16.98%	32.08%	30.19%	20.75%	16.98%	0	10	19	18	12	10
18	Network Transformers	0.00%	0.00%	16.40%	41.45%	42.14%	0.00%	0	0	310	784	797	0
19	Network Protectors	0.00%	0.00%	3.75%	32.25%	64.00%	0.00%	0	0	61	521	1034	0
20	Network Vaults	1.70%	8.80%	72.37%	16.08%	1.04%	10.50%	18	93	769	171	11	112
21	Cable Cambers	0.26%	1.60%	10.77%	50.17%	37.20%	1.86%	28	174	1174	5470	4056	203

Exhibit 2B Section D2 Appendix A: 2014 Audit Results By Asset Class<sup>16</sup>

Toronto Hydro stated in its evidence that the asset condition or health index of an asset would only be used to accelerate the replacement of an asset but the inverse was not true. The better than expected condition of an asset does not factor into the model to delay the replacement of the asset<sup>17</sup>. The OEB is of the view that actual asset condition rather than calculated "end of life" should be the primary determining factor when an asset should be replaced.

Toronto Hydro states that capital replacement is the cornerstone of the Application. Therefore the OEB finds that Toronto Hydro's approach should include more emphasis

<sup>15</sup> School Energy Coalition Toronto Hydro Rates 2015-2019 EB-2014-0116 *Final Argument*, p.34.

<sup>16</sup> SEC Final Argument, p. 37, April 3, 2015

<sup>17</sup> EB-2014-0116 Transcript, Vol. 4, p.140, L 60- 61

on asset condition in the assessment of when a steady state of asset renewal should be achieved. This will require some changes to the proposed capital plan.

### **Productivity Improvements**

The OEB has consistently been clear that distributors need to strive to increase productivity. The OEB has specifically stated that custom applications require that applicants demonstrate productivity improvements. The OEB is not satisfied that Toronto Hydro has incorporated adequate productivity improvements within the Application.

In its evidence, Toronto Hydro relies upon the fact that 81% of capital project jobs are sourced externally and cites this alone as the mechanism which drives efficiency and productivity gains. Toronto Hydro explained that it relies upon a competitive process to cost projects. It provided the example of 6400 units of work being bid with 81% of the costs associated with the capital work program being determined through a competitive process. Four elements make up the type of work bid; materials, civil engineering, electrical design and construction work. The procurement is based on qualified bidders offering individual fixed prices for various units of work. Toronto Hydro explained their rationale as follows:

“once contractors are selected on the basis of their qualifications and overall pricing, they are not guaranteed any particular amount of work. Instead contractors are assigned to individual projects based on their cost to complete each project so that the lowest priced contractor for a particular project gets the work”<sup>18</sup>

Toronto Hydro advanced that the process leads to the best value, while satisfying the operational needs of the utility.

The OEB is concerned that this method of costing may not in fact lead to efficiencies. Competitive bidding for unit cost contracting is not in itself a sufficient demonstration of productivity improvements. For example, Toronto Hydro does not seem to benefit from any of the efficiencies gained by contractors as they undertake similar projects over the period of the plan..

The OEB is not satisfied that bidding 81% of work to a competitive market is sufficient to ensure continuous productivity improvement. While Toronto Hydro provided some evidence on cost containment in respect of negotiated labour rates and performance tracking of its internal staff, it relies heavily on external contractors to achieve productivity improvements. Many parties argued that that Toronto Hydro was lagging in

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<sup>18</sup> Transcript, Vol. 6, pp. 98-108.

productivity, especially when benchmarked against other utilities. Based on the benchmarking results, the OEB does not accept that there are no further productivity gains that can be made over the next five years. The OEB finds that Toronto Hydro must place more emphasis on productivity gains and that Toronto Hydro must find efficiencies over the five years of the capital plan.

### **Length of the Planning Horizon**

The OEB has approached the planning horizon in this Custom IR application by considering the five year horizon as is contemplated in the RRFE. The evidence provided does not convince the OEB that any changes need to be made and the OEB accepts the five years planning horizon that is proposed by Toronto Hydro. The OEB will not require Toronto Hydro to come back to the OEB after two years as was suggested by an intervenor. The OEB has determined that Toronto Hydro has met the RRFE criteria for a custom application, one of which is a requirement for a 5 year plan supported by a DSP. It is in the context of this 5 year plan that the OEB has made its determinations in this case. The OEB also disagrees with Dr. Kaufman that the capital projects should be extended over an 8 year period. Dr. Kaufman was not qualified as an expert in distribution system planning, and the OEB is satisfied that Toronto Hydro has a plan to be able to complete projects within the five years and that it will ensure that it is physically equipped to undertake the work as it has successfully managed large capital programs over the last few years. The OEB is generally satisfied with Toronto Hydro's DSP and rejects the notion that Toronto Hydro's DSP requires oversight by an independent engineer.

### **Reliability**

#### **Benchmarking**

PEG suggested that the reliability benchmarking provided by Toronto Hydro should not be accepted by the OEB. PEG disagreed with the information sources which form the basis of the benchmarking.

While the experts used different information in coming to their conclusions, the OEB notes that both PEG and PSE agree that SAIFI (the frequency of outage measure) performance is below what is expected. The experts disagree on the SAIDI measure (the outage duration measure). PSE states that Toronto Hydro's measure is well below expected measures, while PEG finds that SAIDI is not statistically different from expected levels.

While the OEB does consider the relationship between a distributor's costs and its reliability performance to be important from a regulatory standpoint, at this point, the

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OEB is of the view that statistical methods of comparing distributors costs and service reliability are not sufficiently advanced to be persuasive.

It is the OEB's expectation that one of the outcomes of the capital plan will be better system-wide reliability. While Toronto Hydro submits that there is no direct co-relation between total expenditures and reliability and that the relationship is complex and nuanced, the OEB is of the view that system-wide reliability should improve as a result of the approved capital plan. The OEB expects that improvements in reliability will be demonstrated in Toronto Hydro's reliability statistics which are tracked by the OEB. The OEB encourages Toronto Hydro to pursue this type of analysis and be in a position to provide evidence regarding this relationship at its next full cost of service or Custom IR application.

### **Capital Reduction**

For the reasons stated above, the OEB has chosen to reduce the amount of requested capital spend by 10% annually. Quantifying the amount of capital reduction is not an exact science. The 10% reduction allows an increase over the current budget, but does not allow the significant increase which Toronto Hydro seeks. The amount of the reduction is material. However, the OEB is of the view that there are significant opportunities for Toronto Hydro to improve upon its productivity. This productivity improvement should allow the utility to complete capital projects for a lower cost. By reducing the capital budget by 10%, the OEB has also balanced the capital needs of the distributor with the rate impacts with customers.

### **Business Plans**

Toronto Hydro has proposed 46 specific investment programs. The OEB will not opine on each program. The OEB will not reduce spending in individual programs. It will require Toronto Hydro to work within the approved capital budget and plan accordingly.

### **The Custom C Factor**

#### **Background**

The second custom aspect of Toronto Hydro's Application is a custom capital factor. It is described as a scaling adjustment that will annually incorporate the cost recovery for THESL's capital program from 2016-2019. It is calculated by dividing the difference between the year over year capital requirement by the total revenue requirement. That percentage amount is then added to base rates. The C-factor is the only means of capital recovery proposed for 2016-2019 (after rebasing).

Toronto Hydro proposes the following C-factors listed below:

- 2016 – 4.47%
- 2017 – 8.25%
- 2018 – 6.69%
- 2019 – 5.01 %

Toronto Hydro stated that the premise of the inclusion of a C-factor is to allow it to address the RRFE's statement that the Custom IR framework is suitable for utilities with significant multi-year capital investment requirements, as it is clear that the standard 4<sup>th</sup> Generation IR framework is not. Toronto Hydro further stated the proposed C-factor is designed as a rate adjustment mechanism that is directly proportional to the degree of capital investment required by Toronto Hydro. It is comprised of two sub-components which are designed to: (i) reconcile Toronto Hydro's capital investment needs in a price cap framework, and (ii) return to ratepayers the funding already provided for capital through the standard "I-X" increase.

PEG reviewed the C-factor and stated that it should include an adjustment for the growth in Toronto Hydro billing determinants to prevent the C-factor from over-recovering capital cost. PEG concluded that its recommended C-factor adjustment would eliminate over-recovery of capital costs and reduce Toronto Hydro's price growth by an estimated 1.5% per annum in 2016 through 2019.

Most parties supported the use of the C-factor, though some issues were raised and modifications proposed. Most parties also supported the PEG proposal for some form of billing determinant adjustment. OEB staff submitted that Toronto Hydro's failure to provide five full years of cost forecasts in support of the C-factor calculations resulted in approximations and that more thorough calculations should be provided.

## Findings

The OEB is not opposed to the C-factor mechanism as proposed, but the quantum will change as it relates to revenue requirement to reflect the reduction in capital spending approved by the OEB. Under the Application proposed by Toronto Hydro, the C-factor is the mechanism by which increases in capital spending are funded.

## C-factor growth determinant

### Background

PEG's evidence suggested that the C-factor should include an adjustment for the growth in Toronto Hydro's billing determinants in order to prevent the C factor from over-recovering capital costs. PEG stated that to ensure the C factor recovers only the change in incremental capital spending, it should be modified to reduce the change in

prices by the annual change in a revenue share weighted average of Toronto Hydro's billing determinants. PEG recommended an adjustment estimated at 1.5% per annum in 2016 through 2019. Toronto Hydro did not object to including such a growth factor, but disagreed with the magnitude of the adjustment proposed by PEG and the other parties. Toronto Hydro argued that a more appropriate growth factor adjustment would be closer to 0.3% rather than PEG's proposed 1.5%.

## Findings

The OEB is of the view that a growth factor is reasonable in order to prevent an over-recovery of costs. Toronto Hydro is in the best position to anticipate what its growth factor will be over the term of the rate plan. The 0.3% suggested by Toronto Hydro appears to be reasonable as it is based on Toronto Hydro's detailed forecast of its load and customers by class for the 2015 to 2019 period<sup>19</sup> which has been accepted later in the Decision.

## The ICM Application

The 2012-2014 Incremental Capital Module (ICM<sup>20</sup>) was the source of some discussion in the Application. Parties argued that approximately 86% of proposed capital spending in the five year DSP is similar in nature to the ICM work. Therefore the results of the ICM true up were of interest to many of the parties. Toronto Hydro advised that the ICM true-up was to be completed in 2015 Q2 after 2014 financial close and the full reconciliation by segment of work completed during the ICM period. Toronto Hydro did advise that expenditures for the 2012-2014 ICM program are forecasted to be within 5% of overall OEB-accepted forecast amounts on a three year basis. The OEB observes that projects under the previous ICM application appear to be advancing as scheduled and reasonably within the forecast costs. However, given the limited information that the panel had before it in this proceeding, it did not form the basis of any findings.

## Revenue Requirement

### 3.6 Rate Base (Issue 5.1)

#### Background

The OEB must determine whether the rate base component of the revenue requirement for 2015 is appropriate.

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<sup>19</sup> Reply Argument, p. 193

<sup>20</sup> Ref IR 2B-SIA-15; Ex 1B-T2-S4

The table below, which is reproduced from Toronto Hydro's evidence<sup>21</sup> summarizes its proposed rate base:

	2011 OEB Approved	2011 Historical CGAAP	2012 Historical UGAAP	2013 Historical UGAAP	2014 Bridge UGAAP	2015 Test MIFRS
Opening PP&E NBV	1,897.8	1,895.8	2,183.5	2,251.9	2,356.0	2,436.6
ICM	-	-	-	-	-	372.6
Street Lighting	-	-	-	-	-	39.8
Opening PP&E NBV Adjusted	1,897.8	1,895.8	2,183.5	2,251.9	2,356.0	2,849.0
Closing PP&E NBV	2,105.1	2,183.5	2,251.9	2,356.0	2,456.3 <sup>1</sup>	3,161.0
Average PP&E NBV	2,001.5	2,039.7	2,217.7	2,304.0	2,406.1	3,005.0
Working Capital Allowance	296.7	318.1	316.6	354.4	369.5	241.5
Rate Base	2,298.2	2,357.7	2,534.3	2,658.4	2,775.6	3,246.5

There are two aspects of rate base that the OEB must address: a new working capital allowance rate, and whether Toronto Hydro has correctly applied the "used or useful" principle when adding assets to rate base.

### 3.6.1 Working Capital Allowance

Toronto Hydro has proposed a reduction in its Working Capital Allowance (WCA) from 12.88% of controllable expenses plus cost of power to 8.00% for the 2015 Test year. In support of this reduction, Toronto Hydro filed an updated Lead-Lag Study performed by Navigant Consulting Inc. entitled "Working Capital Requirements of Toronto Hydro Electric System Limited's Distribution Business" dated June 27, 2014. Parties were supportive of Toronto Hydro's updated WCA.

The OEB accepts Toronto Hydro's proposed working capital allowance as reasonable as it was based on an updated lead-lag study.

### 3.6.2 Used or Useful Principle

Some intervenors questioned whether or not Toronto Hydro had correctly applied the "used or useful" principle. SEC argued that Toronto Hydro should revise its in-service forecasts to remove civil work brought into service earlier than the completion of the actual project which includes all in-service additions for Copeland before 2016, unless it meets the actual criteria set out in the OEB's Phase 1 ICM decision. BOMA submitted

<sup>21</sup> EB-2014-0116 Application E2A/T1/S1/p.1 Filed: 2014 Jul 31 Corrected 2015 Feb 6.

that the OEB should not allow assets to be placed in service prematurely, that is not until energized.

Toronto Hydro argued it had correctly applied the “used or useful” principle and noted that SEC and BOMA had objected in general to the addition of assets to rate base unless they are “energized” or conveying electricity to ratepayers. Toronto Hydro submitted that both had materially misinterpreted the OEB’s decision in EB-2012-0064 and were attempting to advance the same incorrect, restrictive definitions of the term “used or useful” that had been expressly rejected by the OEB.

CCC argued that the amount of \$17.3 million associated with the 715 Milner Ave. property should not be included in 2015 opening rate base. CCC submitted that this was an imprudent purchase since two property assessments undertaken showed lower market values. Furthermore, it is not yet used or useful as Toronto Hydro still has an active lease and staff working at the 601 Milner Avenue property which it is planned to replace. VECC expressed general agreement with CCC, but argued that rather than excluding the property entirely from rate base as proposed by CCC, half the property value could be included, based on the assumption that property becomes useful mid-way in the rate plan.

Toronto Hydro argued that the purchase was prudent and no evidence to the contrary had been provided. Toronto Hydro submitted that the purchase price of the property was actually \$15.6 million. Toronto Hydro argued that the purchase price fell between the two valuations which demonstrated the reasonableness of the price.

## Findings

The OEB notes that in its 2013 Toronto Hydro *Partial Decision and Order*<sup>22</sup> the in-service approach had been adopted:

The Board agrees with THESL that the traditional and long established test in Ontario has been the “used or useful” rule. Therefore, the “in-service” approach should more properly be described as the “used or useful” approach. The Board does not anticipate that there will be any material difference for most of the projects, as they are likely to come into service at the same time as they become “useful”. However, in some cases, it may be that THESL’s work has been completed on a project but it is not yet “in service” as work which is the responsibility of other parties has not

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<sup>22</sup> EB-2012-0064 Toronto Hydro-Electric System Limited *Partial Decision and Order*, pp. 13-14.

been completed. In these circumstances, the Board finds that THESL may consider the work to be completed and hence “useful”, even if it is not yet being “used”.

The OEB is satisfied based on the evidence presented by Toronto Hydro that it has correctly applied the “used or useful” principle in the Application. Specifically, the OEB has reviewed the evidence related to the Copeland transformer project and is satisfied that Toronto Hydro has properly applied the “used or useful” principle. The OEB will not require that the asset be energized before additions are made to rate base.

In respect of the specific asset, 715 Milner, the OEB accepts the reply submission of Toronto Hydro in which it clarified the purchase price and confirmed the expected occupancy of the building to be in 2016. The OEB is prepared to accept that some amount of time is required to transition into a new building. Taking a reasonable amount of time to move in to new premises does not disqualify the asset from being used or useful.

### **3.6.3 Renewable Enabling Improvement (REI) Investments**

#### **Background**

Toronto Hydro stated that it expects to connect approximately 972 renewable energy generation (REG) facilities during the 2015 to 2019 rate period, with a corresponding capacity of 148.9 MW.

Toronto Hydro proposed to undertake a number of REI investments as part of its DSP. The OEB has addressed matters related to the DSP in its discussion of Issue 3.2 above.

Toronto Hydro noted that the Ontario Power Authority (OPA) had reviewed its plans for REG investments and found that: 1) the utility’s plans were reasonably consistent with the OPA’s information regarding REG, and 2) that the investments support and enable the connection of additional REG.

Toronto Hydro stated that in accordance with the OEB’s Filing Requirements, it had applied the six percent direct benefit assumption provided by the OEB with respect to REI investments to calculate the provincial rate protection amounts provided in its evidence.

#### **Findings**

The OEB notes that subject to any concerns that may have been expressed related to any of these investments in DSP submissions, no parties raised any concerns with

respect to Toronto Hydro's evidence regarding the proposed cost recovery breakdown related to renewable enabling improvement investments. The OEB accepts Toronto Hydro's proposal, subject to its findings on the DSP in the Decision.

### **3.7 Street lighting Assets (Issue 5.2)**

#### **Background**

Toronto Hydro is proposing to transfer former street lighting assets into its rate base effective January 1, 2015 at a transfer price of \$39.8 million. Toronto Hydro stated that this value represents the opening net book value of the assets in 2015, which is the actual cost incurred by Toronto Hydro to acquire the 2012 transferred assets from TH Energy, the additional assets that were put into service in the intervening 2012 to 2014 period as well as depreciation on all assets. The OEB had, in its Decision and Order dated August 3, 2011, approved a value of \$28.9 million for the assets that were found eligible to be transferred.

Toronto Hydro submitted that the revised transfer value of the street lighting assets has no effect on its revenue requirement for all rate classes other than the Street Lighting and Unmetered Scattered Load (USL) rate classes because the costs associated with the street lighting assets are directly allocated to the street lighting (95%) and the USL (5%) rate classes.

Toronto Hydro stated that for the street lighting class, these costs are offset by revenues from a Service Agreement with the City of Toronto and that for the USL class the effects are minimal.

Toronto Hydro further noted that for the purpose of the present Application, the effects of the proposed transfer have been fully integrated into its capital and operating expenses as well as its cost allocation model.

Toronto Hydro stated that the revenue requirement consequences of its proposal are a base revenue requirement impact of zero.

Parties did not oppose Toronto Hydro's proposal while expressing some concerns. OEB staff noted two implications of the proposed approach:

1. The OEB's Valuation decision of August 3, 2011 had determined that while the use of historic costs was preferable, the DRC valuation technique should be used and as such Toronto Hydro's approach, which uses historic costs, is not strictly in accordance with OEB's Valuation decision. OEB staff however considered that Toronto Hydro has provided adequate justification for its proposed departure from that valuation method.

2. The justification for Toronto Hydro's approach of zeroing out the revenue requirement impact of the transfer of the street lighting assets into Toronto Hydro's rate base is not clear.

OEB staff therefore submitted that there may not be an adequate basis given the evidence on the record to make a determination as to whether or not the proposed arrangements result in a cross-subsidy going from Toronto Hydro to TH Energy or vice-versa.

SIA argued that Toronto Hydro is asking for a second opportunity to present valuation data, essentially revising the original Valuation decision which while undoubtedly more accurate could undermine the finality of the OEB's decision-making process.

SIA argued that Toronto Hydro's justifications as to why an accurate study was not undertaken in 2010 are unclear and unconvincing and suggested the OEB needed to consider whether the merits of improved data accuracy outweigh what appears to be a direct attempt at overturning a prior OEB decision with relatively limited justification.

Toronto Hydro addressed the concern expressed by OEB staff about cross-subsidization between Toronto Hydro and TH Energy. Toronto Hydro submitted that the risk of cross-subsidization between the two entities (if any) is very small because the utility has evaluated the costs of serving the transferred assets and proposes to offset the costs with a corresponding portion of revenue from the City of Toronto contract.

Toronto Hydro stated that the concerns expressed about departing from the OEB's 2011 Decision are unjustified and in any event do not outweigh the merits of approving the transfer on the basis of the most accurate information available.

## Findings

The OEB accepts Toronto Hydro's proposal to transfer former street lighting assets into its rate base at a transfer price of \$39.8 million.

This particular transaction has been the subject of considerable regulatory scrutiny over the past several years. The manner in which records were kept and the fact that the assets were previously owned by the several different entities that predated the merged entity Toronto Hydro creates significant complications in assessing the historic value of the assets.

The OEB is satisfied that the current valuation adequately reflects the historic costs. The pursuit of additional precision is unlikely to yield any benefit.

The OEB accepts that the current valuation was derived with new information that came to light after the OEB had approved a value of \$28.9 million for the assets. The OEB considers the updating of the valuation to be justified because it results in a more accurate representation of costs expended. However the OEB also considers that Toronto Hydro's proposal should have been more reflective of the fact that its proposal was a direct departure from a previous OEB ruling. That ruling was based on a record of financial valuation presented by Toronto Hydro as the most accurate that it could formalize. The OEB accepts that Toronto Hydro believed that to be true but given that it proved not to be the case, Toronto Hydro should have framed its current proposal accordingly from the outset, prior to the discovery phase of this proceeding.

### 3.8 Capital Structure and Cost of Capital (Issue 5.3)

#### Background

Toronto Hydro has proposed using the OEB's deemed capital structure and cost of equity, but proposed its own long and short term debt rates. The proposed rates are shown in the table below:

Line No.	Particulars	Capitalization Ratio		Cost Rate	Return
		(%)	(\$)	(%)	(\$)
	<b>Debt</b>				
1	Long-term Debt	56.0%	\$1,855,547,537	4.31%	\$79,974,099
2	Short-term Debt	4.0% (1)	\$132,539,110	1.38%	\$1,829,040
3	<b>Total Debt</b>	<b>60.0%</b>	<b>\$1,988,086,646</b>	<b>4.11%</b>	<b>\$81,803,139</b>
	<b>Equity</b>				
4	Common Equity	40.0%	\$1,325,391,098	9.30%	\$123,261,372
5	Preferred Shares		\$ -		\$ -
6	<b>Total Equity</b>	<b>40.0%</b>	<b>\$1,325,391,098</b>	<b>9.30%</b>	<b>\$123,261,372</b>
7	<b>Total</b>	<b>100.0%</b>	<b>\$3,313,477,744</b>	<b>6.19%</b>	<b>\$205,064,511</b>

OEB staff, supported by SEC and VECC, expressed two concerns with the cost of long-term debt proposed by Toronto Hydro. The first was that the overall cost rate of 4.31% was not consistent with the more detailed information filed by Toronto Hydro. Toronto Hydro identified and corrected a calculation error in their reply argument.

The second concern related to the \$45 million promissory note due to THC which is due on demand. During cross-examination by OEB counsel,<sup>23</sup> Toronto Hydro was asked to explain why Toronto Hydro would pay its parent company a 6.16 percent coupon rate on a promissory note which is due on demand. Toronto Hydro's response was that this

<sup>23</sup> EB-2014-0116 Transcript, Vol. 7, p.140, L 26 - p. 144, L22

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note “was part of an earlier instrument -2003 Series 1 Note – held by the parent company at the time the note was issued. As a result, the \$45 million promissory note was issued at the same rate as the original instrument.”<sup>24</sup>

OEB staff submitted as it appears that this issue is no longer outstanding at the THC level, it no longer meets the criteria of being written on the same terms as THC debt. OEB staff further noted that the coupon rate of 6.16% is more than 50 basis points higher than any of the other outstanding promissory note issues of Toronto Hydro.

OEB staff submitted that in the absence of an adequate explanation by Toronto Hydro, the OEB should either apply the OEB’s deemed long-term debt rate of 4.77%, or given that Toronto Hydro has recently issued long-term debt in the 4 to 4.15% range deem a lower rate in this range for rate-setting purposes on this debt.

Energy Probe suggested that the OEB should consider whether under this type of Custom IR plan there should be annual adjustments (over a materiality Threshold) made to the cost of debt based on actual debt issues.

Toronto Hydro submitted that it has calculated its debt costs in accordance with the OEB cost of capital methodology and the OEB should accept the evidence as filed and updated. With respect to the \$45 million promissory note due to THC, Toronto Hydro stated that since the 6.16% rate is reflective of market rates at that time it is appropriate to reflect this amount for this particular component of Toronto Hydro’s debt.

No concerns were raised with respect to the short-term debt rate used by Toronto Hydro.

## Findings

The OEB finds that with respect to the long-term debt rate that Toronto Hydro’s correction of the calculation error discussed above addresses this matter.

The OEB finds that the interest rate on the \$45 million promissory note to THC that is to be applied for rate-setting purposes will be the OEB’s 2014 deemed long-term debt rate of 4.77%. The OEB notes that this debt is callable on demand and OEB policy establishes the deemed long-term debt rate as a ceiling on the allowed rate for such debt.

The OEB will not require that annual adjustments be made to the cost of debt based on actual debt issues. The OEB notes that Toronto Hydro is not proposing annual capital cost adjustments and considers such an approach as overly complex and not in

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<sup>24</sup> EB-2014-0116 Oral Hearing Schedule J7.10 Filed: March 2, 2015

alignment with the desirability of minimizing annual adjustments under the Custom IR approach.

### **3.9 Depreciation (Issue 5.4)**

#### **Background**

Toronto Hydro stated that it depreciates its assets in accordance with the Accounting Procedures Handbook (APH) and that it had not made any significant material changes to its estimated useful lives since its last rebasing application (EB-2010-0142) except for amortizing a software application Customer Care and Billing over 10 years rather than the previous four or five years.

No party took issue with Toronto Hydro's depreciation policy.

#### **Findings**

The OEB finds that Toronto Hydro's depreciation policy is appropriate.

The OEB notes that the depreciation component of the revenue requirement is dependent on the approved level of capital expenditures.

Subject to the impacts of the adjustments to capital expenditures outlined in section 3.5, the OEB finds that the depreciation component of the revenue requirement is appropriate.

### **3.10 Taxes/PILs (Issue 5.5)**

#### **Background**

Toronto Hydro's rate Application was prepared using USGAAP for the historical and bridge years, and MIFRS for the test year, while the PILS calculation was prepared using MIFRS for both the bridge and test years. Toronto Hydro indicated that this was done to be able to reconcile 2015 MIFRS amounts in the PILS model.

#### **Findings**

The OEB notes that no parties commented on Toronto Hydro's proposed taxes/PILs component of the 2015 revenue requirement.

The OEB approves the taxes/PILs component of the 2015 revenue requirement, subject to any necessary adjustments for the OEB's findings in other sections of the Decision which impact the taxes/PILs component.

### 3.11 Revenue Offsets (Issue 5.6)

Toronto Hydro's revenue offsets, as updated in the Wireline Pole Attachment Rate Settlement Proposal is summarized below<sup>25</sup>:

Description	Actual Year 2011	Actual Year 2012	Actual Year 2013	Bridge Year 2014	Test Year 2015
Specific Service Charges Excluding Pole Attachment (4235)	\$5.7	\$6.3	\$6.4	\$6.4	\$9.8
Late Payment Charge (4225)	\$4.2	\$4.0	\$3.8	\$4.0	\$4.0
Other Distribution Revenue Excluding Duct Rental (4082,4084,4090,4210,4215,4220)	\$3.9	\$3.7	\$3.7	\$3.4	\$11.5
Other Income & Deductions Including Pole Attachments (4210, 4235, 4324, 4325,4330,4335,4355,4375,4398,4405)	\$18.8	\$5.3	\$11.5	\$12.0	\$15.9
<b>Total Revenue Offset</b>	<b>\$32.6</b>	<b>\$19.4</b>	<b>\$25.4</b>	<b>\$25.7</b>	<b>\$41.3</b>

The OEB notes that the wireline attachment pole rate has been dealt with through the settlement proposal of June 11, 2015 which the OEB accepted.

Revenue offsets are also impacted by specific service charge amounts which are dealt with separately in Issue 6.6.

### Findings

The OEB finds that the revenue offset component of the revenue requirement is appropriate, subject to its findings under issue 6.6 related to specific service charges.

### Load Forecast, Cost Allocation and Rate Design

#### 3.12 Load Forecast (Issue 6.1)

##### Background

Toronto Hydro prepared load forecasts for each year from 2015 to 2019. The load forecast was prepared according to the OEB's filing requirements using a multivariate regression load model that has been employed by Toronto Hydro since 2006. It includes an explicit forecast of CDM savings.

Toronto Hydro's total load, customer and distribution revenue forecast is summarized in Table 1: Total Loads, Revenues and Customers of its evidence which is reproduced below.<sup>26</sup> Toronto Hydro stated that the revenue forecast is calculated based on

<sup>25</sup> EB-2014-0116, Wireline Pole Attachment Rate Settlement Proposal, p.5: 2015 Jun 11

<sup>26</sup> EB-2014-0116 Application E3/T1/S1, p.1 Filed: 2014 Jul 31 Corrected: 2015 Feb 6

proposed distribution rates, excluding commodity, rate riders, and all other non-distribution rates.

YEAR		Total Normalized GWh	Total Normalized MVA	Total Distribution Revenue (\$M)	Total Customers
2009	Actual	25,572.8	42,754.7	\$475.2	689,399
2010	Actual	25,607.2	43,273.3	\$519.3	696,729
2011	Actual	25,419.0	43,020.2	\$522.2	705,756
2012	Actual	25,639.2	43,544.5	\$527.9	713,093
2013	Actual	25,213.2	42,658.7	\$529.5	724,144
2014	Bridge	25,018.5	42,712.7	\$539.4	736,974
2015	Test	24,993.3	42,697.2	\$655.1	749,679
2016	Test	25,027.4	42,806.2	\$692.8	763,091
2017	Test	24,841.6	42,631.3	\$754.4	773,850
2018	Test	24,696.9	42,584.4	\$810.5	785,107
2019	Test	24,611.4	42,529.2	\$857.8	796,865

Notes:

1. Total Normalized GWh are purchased GWh (before losses), and are weather normalized to the Test Year heating and cooling degree day assumptions.
2. Total Normalized MVA are weather normalized MVA.
3. Total Distribution Revenue is weather normalized and includes an adjustment for the Transformer allowance.
4. Total Customers are as of mid-year and exclude street lighting devices and unmetered load connections.

OEB staff argued that as this table shows that Toronto Hydro's load forecast projects a 2.4% decline in Total Normalized GWh from 2013 to 2019, while at the same time total customers are projected to increase by 10%. The results are anomalous and the load forecast should not be accepted by the OEB. OEB staff urged the OEB to use the 2013 actual results instead.

VECC questioned whether gross or net CDM results should be incorporated into the load forecast.

## Findings

The OEB accepts Toronto Hydro's load forecast as filed.

The OEB notes that Toronto Hydro's total customer count has been increasing steadily from 2009 to 2014, while Total Normalized GWh has been decreasing, so the forecast going forward appears to continue this trend. Toronto Hydro's evidence was that the forecasts and actual results have tracked within 1% over the historic period.

Toronto Hydro also pointed out that many factors contribute to energy consumption beyond customer numbers. Demographics, type of customer and housing unit, and energy conservation all play a part.

The OEB observes that some increase in customer count can also be attributed to the fact that some multi-unit residential buildings which historically were billed as one customer have been converted into Competitive Sector Multi- Unit Residential customers where each unit is billed separately. This increases the overall customer count without changing any other parameter such as occupancy or consumption.

The OEB also agrees with Toronto Hydro that the use of gross CDM to model and forecast loads is more accurate because it represents the real impact of CDM activity. While net CDM, excluding free-riders and “natural conservators”, is important for other purposes such as the calculation of LRAM, for the purpose of a load forecast, it is actual consumption that matters. The reasons for conservation are irrelevant for this purpose.

### **3.13 Rate Classes (Issue 6.2)**

Toronto Hydro did not propose any changes to its existing rate classes, nor did any other party request such changes. The OEB approves the continued use of the rate classes and definitions in Toronto Hydro’s tariff sheet.

### **3.14 Cost Allocation Model Inputs (Issue 6.3)**

#### **Background**

Toronto Hydro has reviewed and updated all of the inputs to the cost allocation model. The load profiles for each class have been updated to reflect the most recent full year of data available (2012) and the profiles use metered data for each rate class, weather normalized to 2015 heating and cooling degree days.

As required by the EB-2010-0142 decision with respect to the new CSMUR class, Toronto Hydro has reviewed each of the assumptions underlying that application. Toronto Hydro’s evidence is that it has not found any need for revisions, and that the assumptions used for allocations to the CSMUR class remain unchanged.

The EB-2010-0142 decision also directed Toronto Hydro to establish a tracking account to record amounts related to the allocation of costs and revenues between the CSMUR class and the GS >50 classes depending on whether the CSMUR customers are to be considered bulk customers or customers in the CSMUR class.

Toronto Hydro stated it considered that a tracking account is unnecessary as this is a cost allocation issue, and effectively there are no real costs to track. Toronto Hydro advised the OEB that the issue is best addressed through scenarios using the Cost Allocation Model as that better demonstrates the potential effect of the CSMUR class on the costs and revenues allocated to the GS >50 class. Toronto Hydro ran models using

these scenarios and concluded that in the absence of the CSMUR class, the GS 50-999 class rates would increase slightly.

Issues raised by the parties concerned:

1. the cost allocation used for street lighting,
2. updates to the model
3. revenue to cost ratios

### **Street lighting**

Toronto Hydro noted that it had incorporated approved street lighting assets and operating expenses into its 2015 revenue requirement. For the purposes of cost allocation, it had directly allocated all assets and expenses 95% to the Street lighting class, and 5% to the Unmetered Scattered Load class.

Toronto Hydro stated that this allocation reflected the fact that these assets are serving only these two classes currently and ensured no other rate classes are allocated these costs. In addition, Toronto Hydro noted that for the Street lighting class 100% of the additional revenue requirement is offset through a direct allocation of the revenues received through the existing street lighting contract to Revenue Offsets for the Street lighting class. The effect is that for these assets and costs, the revenue-to-cost ratio is 1.0.

SIA submitted that the OEB should direct Toronto Hydro to perform its cost allocation to the Street lighting rate class on the same basis as all other classes. SIA did not accept Toronto Hydro's claim that it was keeping street lighting rates constant at 2014 rates on the basis that the OEB is still looking into one of the important components of the cost allocation model when it comes to street lighting.

### **Updates to the model**

VECC argued that the next time Toronto Hydro updates its cost allocation model it should be directed to undertake a new minimum system study that would reflect its circumstances if it proposes to depart from the OEB's default values.

Toronto Hydro suggested this be done by the OEB so all LDCs can benefit.

VECC also suggested that the OEB should correct issues regarding the determination of the cost allocation model's composite allocators prior to its release to distributors filing their 2016 cost of service based rate applications.

## Findings

The OEB will not require Toronto Hydro to undertake a new minimum system study as proposed by VECC pending a generic determination by the OEB as to its approach to cost allocation model updates and issues.

### 3.15 Revenue-to-cost Ratios (Issue 6.4)

Toronto Hydro's proposed revenue-to-cost ratios are within the OEB target ranges as is shown in the Table below:<sup>27</sup>:

Rate Class	2011 OEB Approved	2015		OEB's Guideline Ranges
		Model	Proposed	
Residential	89	94	94	85-115
Competitive Sector Multi-Unit Residential		110	100	
General Service <50kW	97	90	92	80-120
General Service 50-999kW	118	119	119	80-120
Intermediate 1000-4999kW	124	102	102	80-120
Large Use	116	95	96	85-115
Streetlighting	71	92	82	70-120
Unmetered Scattered Load	82	87	89	80-120

## Findings

Some intervenors argued that despite falling within the OEB's Guideline ranges adjustments should be made to Toronto Hydro's proposed ratios. Toronto Hydro's proposal is that the Guideline is clear that if the ratios fall within the range, the OEB will not require changes.

SEC submitted that the OEB should order Toronto Hydro to file a plan to bring all classes within the 90%-110% range recently approved by the OEB in EB-2013-0416 for Hydro One.

The OEB observes that the context was quite different for Hydro One. Hydro One itself had proposed moving all customer classes to ranges of 98%-102%. The 90% - 110% range was imposed by the OEB as a mitigation measure as many of Hydro One's customer classes were outside the range and the OEB was not persuaded that the data

<sup>27</sup> EB-2014-0116 Application E7/T1/S1/p. 7 Filed 2014 Jul 30 Corrected 2015 Feb 6

supported a move to the narrow range proposed by Hydro One. The OEB does not view the Hydro One decision as a precedent for requiring LDCs that are already within the approved range to make further changes.

### **Street lighting**

SIA and VECC submitted that Toronto Hydro should be required to perform its cost allocation to the Street lighting class on the same basis as all other classes. SIA does not believe that there is any reason to limit the application of current policy and freeze rates for one class on the basis of speculative expectations about future changes to an applicable policy. SIA argued that this approach had been rejected by the OEB when a similar argument had been brought before it as part of a motion by the City of Hamilton requesting that Hydro One's street lighting rates be declared interim.

The OEB agrees with Toronto Hydro that that since the revenue to cost ratio determined in this hearing will apply for the next five years and since the proposed rates result in a revenue to cost ratio for this class that is significantly more than when last approved while still well within the OEB's guidelines, its proposal is appropriate.

### **3.16 Fixed and Variable Charges (Issue 6.5)**

Toronto Hydro is proposing fixed and variable rates for all rate classes based on the current split of revenue generated through these components. Toronto Hydro noted that the OEB has initiated a process to review rate design for the Residential and GS<50 kW rate classes, but that it has not incorporated any of the rate designs as outlined in the Draft Report of the Board. Toronto Hydro plans to incorporate any changes required by the OEB once the review is completed.

Toronto Hydro provided its proposed monthly fixed charges for each customer class in the table below:<sup>28</sup>

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<sup>28</sup> EB-2014-0116 Application E8/T1/S1/p. 6 Filed: 2014 Jul 31 Corrected: 2015 Feb 6

	Residential	CSMUR	GS<50 kW	GS 50-999 kW	GS 1000-4999 kW	Large Use	Streetlighting	USL
CA Model Floor	4.24	3.40	13.78	43.31	82.72	-35.83	0.23	9.53
CA Model Ceiling	19.34	9.32	31.66	86.22	244.36	210.01	10.53	19.32
Current (2014)	18.63	17.35	24.80	36.29	700.68	3,071.47	1.32	4.94
Proposed (2015)	22.72	18.90	30.43	43.63	831.65	3,668.99	1.32	6.12

Toronto Hydro noted that the OEB's Cost Allocation model produces estimates of the floor and ceiling monthly fixed rates for each rate class based on data from the model. Toronto Hydro stated that the proposed fixed rate for the Residential, CSMUR, GS 1000-4999 kW, and Large Use classes is above the ceiling calculated by the model. Toronto Hydro explained that for the Residential and CSMUR classes, this results from changes in inputs to the Cost Allocation model as well as maintaining the fixed variable split at current levels. Toronto Hydro noted that the new OEB policy will require all distributors to structure residential rates that are 100% fixed by 2019 and that the proposed fixed rates for the Residential and CSMUR classes generally conform with this policy.

For the GS 1000-4999 kW and Large Use classes, Toronto Hydro noted that the fixed charge has been above the ceiling rate since information from the Cost Allocation model has been provided in 2006. Toronto Hydro further noted that the proportion of total revenue recovered through the fixed rate for the GS 1000-4999 kW and Large Use classes is less than 10%.

While most aspects of the fixed variable split were accepted by intervenors and OEB staff, VECC and Energy Probe argued that for the Residential Class, the monthly fixed charge should not exceed the ceiling value calculated by the Cost Allocation Model. This would be consistent with OEB policy, and would also reduce the bill impacts to be experienced by Residential customers.

### Residential Rate Design

Currently, all residential distribution rates include a fixed monthly charge and a variable usage charge. The OEB's April 2, 2015 policy on electricity distribution rate design set out that distribution rates for residential customers will transition to a fully fixed rate structure from the current combination of fixed and variable charges over four years. Starting in 2016, the fixed rate will increase gradually, and the usage rate will decline.

The OEB is requiring distributors to calculate and report on the rate impacts of the change so that strategies may be employed to smooth the transition for the customers most impacted, such as those that consume less electricity, if mitigation is required. In support of this, the OEB requires distributors to calculate the impact of this change to residential customers in general; it also requires applicants to calculate the combined impact of the fixed rate increase and any other changes in the cost of distribution service for those customers who are at the 10<sup>th</sup> percentile of overall consumption. Any increase of 10% or greater to these low-consumption customers' bills arising from changes made in this Decision, or an increase to the monthly fixed charge of greater than \$4 prior to incentive rate-setting adjustments, may result in the requirement for a longer transition period than four years specified in the OEB policy. Distributors may also propose other strategies to smooth out these increases as appropriate.

### **Findings**

The OEB accepts the fixed variable splits proposed by Toronto Hydro. The OEB recognizes that the Residential Class fixed charge is slightly higher than the current ceiling but anticipates that the new policy will soon require a higher fixed charge in any event.

The OEB expects that Toronto Hydro will implement the transition to fully fixed residential rates in 2017.

### **3.17 Charges for Specific and Miscellaneous Services Charges (Issue 6.6)**

Toronto Hydro proposes to continue using previously approved standard charges, but is applying to update specific service charges to reflect the actual cost of providing the services.

### **Findings**

The Wireline attachment charge has already been approved by the OEB.

Issues were raised about the general concept of utility-specific charges, increases proposed for the reconnection charge, and the proposal to charge customers for missed appointments.

The OEB finds that Toronto Hydro's proposals to reflect actual costs comply with the requirements of the Distribution Rate Handbook. The OEB does not approve charges to customers for missed appointments. While Toronto Hydro is correct that it has standards to meet regarding missed appointments, it does not require 100%

compliance, and more importantly, does not compensate the affected customer when it misses an appointment.

### **3.18 Line Losses (Issue 6.7)**

In the Settlement Agreement approved by the OEB in Phase II of Toronto Hydro's ICM application (EB-2012-0064), Toronto Hydro agreed to evaluate options to measure or estimate actual line losses and the impacts on Account 1588 balances. Subsequently, the OEB conducted an audit of Toronto Hydro's Group 1 and Group 2 Deferral and Variance accounts (the OEB Audit), which made a finding related to Toronto Hydro's approach of recording variance amounts in account 1588 RSVA Power. As a result, Toronto Hydro, in consultation with OEB audit staff, has undertaken a significant amount of work to accurately estimate the correct balances in the RSVA accounts. This included analyzing and estimating the actual loss factors from 2009 to 2013.

These efforts are ongoing, so Toronto Hydro proposes that the current OEB-Approved loss factors be continued until the OEB Audit concludes. Once the OEB Audit is completed, if changes to the approved loss factor are warranted, Toronto Hydro intends to apply to incorporate the revised loss factor into distribution rates.

#### **Findings**

The OEB agrees with OEB staff that Toronto Hydro's update on line losses should take all relevant factors into account, and not be limited to a variance analysis of actual versus deemed losses, but also notes that the implications for loss factors of the work proposed by Toronto Hydro are complex. Toronto Hydro's current loss factors are among the lowest in the province.

The OEB expects Toronto Hydro to incorporate the result of the OEB audit into its distribution rates as well as to update its loss factors at its next full cost of service or Custom IR rate application.

### **3.19 Monitoring and Reporting Proposals (Issue 2.4)**

#### **Background**

Toronto Hydro's annual reporting section of the Application made monitoring and reporting proposals: (a) Annual Reporting, consisting of meeting the OEB's Scorecard Approach for Performance Measurement, reporting on the proposed performance measures framework as detailed in the DSP and filing a rate schedule for the following year upon the OEB's update of its inflation factor. (b) ICM True-up – Deferral proposal for which Toronto Hydro stated its accounting process is not expected to have a final report of actual in-service additions (ISAs) for 2014 until the second quarter of 2015.

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Toronto Hydro proposed to defer the ICM true-up and bring forward a separate application in 2015, once the actual ICM amounts are known.

Intervenors and OEB staff generally took the view that Toronto Hydro's monitoring and reporting proposals were inadequate and suggested various ways to address these concerns including the establishment of specific performance targets for the proposed measures and additional measures that would provide a stronger focus on benchmarking and productivity. A number of parties argued that more specific information should be provided that would allow for approved capital expenditures by asset class to be assessed against resulting performance and reliability improvements and OM&A savings.

Some parties suggested additional review measures to occur during the Custom IR period. These included suggestions for annual program reviews, or that Toronto Hydro be directed to work with OEB staff and intervenors to develop appropriate annual reporting requirements, meaningful metrics and associated targets.

Toronto Hydro stated that it did see merit in receiving the input of stakeholders and discussing the outputs of its metrics mid-way through the Custom IR plan, and submitted that it would be of assistance to conduct a workshop on these measures with interested parties in 2018.

## Findings

The OEB will accept Toronto Hydro's proposals for monitoring and reporting contained in the Application. The OEB, however, will expect Toronto Hydro to develop better performance metrics as part of its ongoing customer engagement efforts with the objective of achieving greater conformity with the general intent of the RRFE.

The OEB will not require Toronto Hydro to hold a stakeholder session in 2018. It is Toronto Hydro's responsibility to develop these measures and to undertake such activities as it sees appropriate to do so.

The OEB is of the view that the key reason for the requests for additional reporting requirements is a desire to expose cost savings. The OEB considers that rather than directing Toronto Hydro to implement additional monitoring and reporting at the present time, this matter is best addressed after Toronto Hydro has had time to consider the OEB's findings in this Decision and developed new measures.

The OEB will for the present address the concerns about cost savings by ordering the implementation of the earnings sharing mechanism proposed by Toronto Hydro in its reply argument. The OEB will outline this finding in further detail in the next section of the Decision.

## 3.20 Off-ramps and Annual Adjustments (Issue 2.5)

### Background

Toronto Hydro noted that the RRFE indicates that each rate-setting method includes a trigger mechanism with an annual return on equity dead band of plus or minus 300 basis points, at which point a regulatory review may be initiated. Toronto Hydro proposed to apply the OEB's existing policy with respect to off-ramps.

Toronto Hydro stated that it proposed to incorporate within its rate framework the availability of Z-factor relief, which Toronto Hydro understood is available to Custom IR filers as part of the RRFE framework. Toronto Hydro requested guidance from the OEB with respect to certain proposed Z-factor criteria.

Parties were generally opposed to Toronto Hydro's request that the OEB provide it with additional guidance with respect to certain proposed Z-factor criteria, agreeing with the views of OEB staff that the OEB has established the criteria for Z-factor applications on a generic basis and should Toronto Hydro wish to make a Z-factor application during the term of the approved Custom IR plan that it should be on the basis of these criteria.

BOMA argued that the OEB should direct Toronto Hydro to enter into an earnings sharing proposal similar to the one the OEB directed should be included in the Enbridge Gas Distribution Custom IR plan<sup>29</sup>. BOMA suggested that such a plan would incorporate a 50 point dead band for the utility with 50-50 sharing of excess earnings over 50 basis points. CCC also supported the inclusion of an earnings sharing mechanism.

Toronto Hydro submitted that requests for an earnings sharing mechanism should be rejected, but if such a mechanism was to be approved it should be symmetrical and incorporate a 100 basis point dead band. Toronto Hydro argued that this was appropriate having regard to the explicit benefit sharing mechanism (the stretch factor) already embedded in the rate framework. Toronto Hydro further submitted that earnings in excess of the 100 basis point dead band but below the 300 basis point off-ramp should be split on a 50/50 basis with customers. Furthermore, any approved ESM should necessarily only track the variance between the non-capital related revenue requirement embedded in rates and the actual non capital related revenue requirement.

### Findings

The OEB will not provide the additional guidance requested by Toronto Hydro with respect to certain Z-factor criteria which it had proposed. The OEB has already established the criteria for Z-factor applications on a generic basis and it is open to

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<sup>29</sup> Enbridge Gas Distribution EB-2012-0459, August 22, 2014

Toronto Hydro to make Z-factor applications on the basis of these criteria should it wish to do so.

The OEB has decided to adopt the earnings sharing mechanism (ESM) proposed by Toronto Hydro. The OEB finds that the ESM will be symmetrical and incorporate a 100 basis point dead band. Earnings in excess of the 100 basis point are to be split on a 50:50 basis with ratepayers.

As the OEB will also be approving the proposed Capital Related Revenue Requirement Variance Account (CRRRVA), the ESM will only track the variance between the non-capital related revenue requirement embedded in rates and the actual non capital related revenue requirement. Toronto Hydro should include a detailed explanation as to how it believes the ESM would operate as part of its Draft Rate Order supporting material.

The OEB is of the view that the establishment of the ESM will allow Toronto Hydro's customers to benefit from efficiency gains achieved during the course of the Custom IR Plan and thereby alleviate the need for additional reporting requirements to track savings achieved during the term of the plan.

## **Deferral and Variance Accounts and Rate Riders**

### **3.21 Existing Deferral and Variance Accounts (Issue 4.1)**

Toronto Hydro did not propose that any of its existing deferral accounts be terminated with the exception of Account 1508 – Transit City. No party objected to this proposal.

#### **Findings**

The OEB accepts Toronto Hydro's proposal.

### **3.22 New Deferral and Variance Accounts (Issue 4.2)**

In addition to the new variance account for OPEBs established in Section 3.3.7, Toronto Hydro has requested approval for seven new deferral and variance accounts:

1. Variance Account for Externally Driven Capital,
2. Variance Account for Derecognition,
3. Renewable Enabling Investments Provincial Rate Protection Recovery,
4. Deferral Account for the Mandatory Transition to Monthly Billing
5. Variance Account for Gains on Sale of Properties related to the Company's Operating Centers Consolidation Program;

6. Variance account for 2015 opening rate base to capture prudence-based ICM disallowances; and
7. Variance account for Capital Related Revenue Requirement to capture the revenue requirement implications of shortfalls in capital spending over the 2015-2019 period relative to amounts approved in this Application

### **Variance Account for Externally Driven Capital**

In this account Toronto Hydro proposes to capture the difference between the amounts included in rates related to capital spending on third party initiated relocation and expansion projects and the amounts actually spent from 2015 to 2019. Toronto Hydro's evidence is that it has no discretion in making these investments. Toronto Hydro's reasons for establishing this account are to manage the uncertainty and volatility surrounding this type of project, and to protect ratepayers from potential over recovery.

None of the parties objected to the creation of the account; however some argued that the amount included in rates for this work at \$4 million annually is too low, which could result in large balances to be recovered later from ratepayers. Toronto Hydro did not object to including a higher amount in rates, but did point out that the work is uncertain and may not materialize.

### **Findings**

The OEB approves this account as requested. As these projects are completely outside Toronto Hydro's control as to both need and timing, they are appropriate for a variance account. Given the size of Toronto Hydro's overall budget, the OEB is not inclined to require Toronto Hydro to include a larger portion of these expenditures in its budget. The OEB recognizes the risk of this approach is there may be a significant recovery from ratepayers when the account is cleared, but is of the view that is preferable to the risk of ratepayers paying now for work that may not materialize. The issues of prudence and recovery periods will be dealt with as usual when Toronto Hydro applies to clear the balance of this account.

The OEB does not agree with Energy Probe's suggestion that there be a materiality threshold for each project before it can be added to the account. This is needlessly complicated and inconsistent with the operation of other variance accounts.

### **Variance Account for Derecognition,**

The purpose of this account is to record costs associated with derecognition of assets as a result of accounting treatment under IFRS. None of the parties objected to the need for this account, however SEC noted that the amounts could be significant and

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suggested that the OEB establish a policy review of the accounting treatment of derecognition losses.

### **Findings**

The OEB finds that this account is appropriate. This impact of derecognition expenses was considered by the OEB in its IFRS Report Addendum<sup>30</sup> and Toronto Hydro's approach is consistent with it. While further review may be warranted, this is not a reason not to establish this account at this time.

### **Renewable Enabling Investments Provincial Rate Protection Recovery**

Toronto Hydro requested approval for the establishment of a new variance account for the purpose of tracking the variance between Toronto Hydro's revenue requirement required to support the portion of the investments that are eligible for the provincial rate protection, and the actual Provincial Rate Protection amounts collected from the IESO.

Toronto Hydro stated that the proposed variance account is being requested in accordance with the OEB's guidance in the Filing Requirements and supporting appendices.

The OEB approves Toronto Hydro's request.

### **Deferral Account for the Mandatory Transition to Monthly Billing**

The purpose of this account is to capture the costs and benefits of a transition to monthly billing. Toronto Hydro anticipates that based on the OEB's notice of proposal to change the distribution system code to require all distributors to implement monthly billing it will be required to do so during the term of this Custom IR.

Some intervenors objected to the establishment of this account.

VECC objected on the basis that if the OEB orders Toronto Hydro to implement monthly billing adjustments should be made to the capital and operating budgets and revenues to account for it.

CCC argues that it is premature at this time to establish a deferral account to capture costs associated with monthly billing as there has not been evidence presented that the costs will outweigh the benefits and it is unclear whether the incremental costs would meet Toronto Hydro's materiality threshold. CCC suggested a Z-factor could be used, but the OEB agrees with Toronto Hydro that these costs are unlikely to meet the test for a Z-factor as the event is not unexpected.

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<sup>30</sup> EB-2008-0408, June 13, 2011 p. 23

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## Findings

The OEB approves the account as requested by Toronto Hydro.

The timing and costs of the transition are as yet unknown which makes a deferral account appropriate. No amount has been included in Toronto Hydro's Application for this purpose.

### **Variance Account for Gains on Sale of Properties related to the Company's Operating Centers Consolidation Program**

Toronto Hydro has forecast proceeds from the sale of two properties. The purpose of this account is to track the difference between the forecast sale price which is already being credited to ratepayers through a rate rider and the actual proceeds of sale.

The OEB agrees with Toronto Hydro that this is the appropriate approach rather than the alternative suggested by SEC - a deferral account for property sales to which the difference between sale price and net book value is credited as SEC's approach is overly complex.

### **Variance account for 2015 opening rate base to capture prudence-based ICM disallowances**

The ICM true up process is a revenue reconciliation exercise between the 2012-2014 capital related revenue requirement approved by the OEB in the ICM proceeding (EB-2012-0064) and the actual ICM-eligible work completed by Toronto Hydro over this period. This process has not been completed, and if the OEB finds any of the ICM work to be imprudent, there will be an impact on the opening rate base for 2015.

The purpose of this variance account is to capture any differences between amounts to be included in 2015 rate base related to ICM work undertaken in 2012-2014, and any disallowance based on prudence that may result from the ICM true-up process.

There were no objections to the creation of the account, and the OEB finds that it is appropriate.

As the ICM amounts will be dealt with in a future proceeding the OEB need not decide on the manner in which amounts will be recorded to the account at this time.

### **Variance account for Capital Related Revenue Requirement (CRRRVA)**

In order to protect ratepayers, SEC recommended the establishment of a variance account to track the revenue requirement associated with approved in-service capital additions and actuals, if they were less than approved. AMPCO supported this

recommendation. The creation of such an account would allow Toronto Hydro to catch up in subsequent years as long as it did not go over the cumulative total and would ensure that if Toronto Hydro is behind on its capital program in any given year, ratepayers are to be held whole.

Toronto Hydro submitted that although concerns of some parties about the potential for over-recovery if actual in-service amounts are less than forecast in a given year are unfounded, it nevertheless proposes a capital related revenue requirement variance account to address any concerns relating to the company's ability to place capital in-service over the Custom IR term. However, it is critical to Toronto Hydro that the CRRRVA operate on a cumulative basis rather than annually as it is only if it operates on a cumulative basis that Toronto Hydro can maintain the required flexibility to plan and execute its capital investment strategy in response to the various factors that may require the shifting of projects and project spending earlier or later in the Custom IR term.

The OEB approves the creation of the CRRRVA account.

### **3.23 Accounts, Balances and the proposed Disposition of Deferral and Variance Accounts (Issue 4.3)**

In general, none of the parties objected to the balances in the existing deferral accounts, the proposed allocation methodology, or the resulting rate riders.

Toronto Hydro had originally proposed to dispose of all Retail Settlement Variance Accounts (RSVAs) including Account 1550 LV Variance. However work is still ongoing to address some outstanding issues identified during an OEB audit of these accounts. As a result, Toronto Hydro proposes to defer the disposition of the RSVAs (except Account 1550 as this account was not impacted by the audit finding) and to continue to book monthly amounts to the accounts in the ordinary course. Toronto Hydro stated that it expected to update the balances in the accounts and request disposition as part of its update to 2016 distribution rates.

The OEB approves Toronto Hydro's proposed disposition of accounts and its request to defer the disposition of the RSVA accounts. Upon conclusion of the OEB audit, the OEB expects Toronto Hydro to request disposition of all the RSVA balances in its next rate application.

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**Accounts 1518 and 1548****Background**

Since Toronto Hydro's Regulatory Assets Phase 2 decision (RP-2004-0117) in 2004, Toronto Hydro has included the costs and revenues associated with providing retail services in the determination of its revenue requirement and has not recorded amounts in Account 1518 RCVA Retail and Account 1548 RCVA Service Transaction Request. Toronto Hydro interpreted the Regulatory Assets Phase 2 decision to mean that the tracking of amounts in the accounts was no longer necessary. The OEB staff audit finding indicates that these amounts should be recorded, although Toronto Hydro's failure to report any amounts in these accounts since 2004 seems not to have been of concern to OEB staff.

Toronto Hydro indicated that from 2011 to 2013, had variances been recorded in Accounts 1518 and 1548, they would amount to approximate credits of \$272k and \$19k in total respectively.<sup>31</sup> As Toronto Hydro believes the amounts continue to be immaterial, Toronto Hydro is requesting relief from having to track and record costs and revenues in Accounts 1518 and 1548 and will include these amounts as a part of its requested revenue requirement in the current and future applications.

**Findings**

While these accounts may technically be required, the amounts involved are not material. As observed by OEB staff, ratepayers will not be harmed as the associated revenues and costs have been incorporated into Toronto Hydro's revenue requirement, although OEB staff argued that for the sake of consistency with other distributors, Toronto Hydro should be required to use them.

The OEB agrees with Toronto Hydro that there is no benefit in recording and reporting the amounts in these accounts and will not require it to do so.

**Account 1592****Background**

Toronto Hydro proposed to clear a credit of \$1.2 million in Account 1592 PILs and Tax Variances for 2006 and Subsequent Years, Sub-account HST/OVAT Input Tax Credits (ITCs). The balance pertains to the period of July 1, 2010 to December 31, 2010. In its Application, Toronto Hydro provided the calculation of the amount it has recorded in the sub-account of Account 1592. Toronto Hydro used the 2009 actual PST paid for

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<sup>31</sup> EB-2014-0116 Application E 9/T1/S1, p. 20

operating and capital expenses as the basis for the calculation. Toronto Hydro is proposing to return 100% of the estimated savings.

OEB staff pointed out that 50% rather than 100% of the savings are supposed to be returned to ratepayers, but suggested the OEB approve Toronto Hydro's proposal as it is in the ratepayer's favour.

As the amount involved does not meet Toronto Hydro's materiality threshold, the OEB will approve Toronto Hydro's proposal. However, the OEB notes that OEB policies should be followed when material amounts are involved, regardless of whether shareholders or ratepayers benefit,

### **Account 1575**

Toronto Hydro proposed to dispose of a debit of \$30.5 million (composed of an account balance of \$25.8 million and \$4.7 million return) in Account 1575 IFRS-CGAAP Transitional PP&E Amounts over a four year period. Of this amount, approximately \$25.7 million is due to derecognition losses.

### **Findings**

The OEB approves the disposition of the balances in this account. The only objections raised by OEB staff concerned the accounting treatment of items below the materiality threshold.

### **Other Post Employment Benefits (OPEB)**

Account 1508 – USGAAP Deferral Account.

OEB staff noted that the OEB approved Account 1508-USGAAP Deferral Account in an accounting order application (EB-2012-0079) to capture the post-employment benefit difference arising from Toronto Hydro's transition from CGAAP to USGAAP. As at December 31, 2013, the account had a balance of \$38.8 million.

Toronto Hydro has indicated that as a result of its transition to IFRS, there is a transitional difference from USGAAP to IFRS and the estimated balance in the account as at December 31, 2014 is expected to be \$36 million.

Toronto Hydro requested approval to continue to use this deferral account to capture ongoing differences in OPEBs as a result of its transition from USGAAP to IFRS. In this application, Toronto Hydro is not seeking recovery for the account. Toronto Hydro indicated that it projects interest rates are more likely to increase over the Custom IR period, which would reduce the amount recorded in the account.

Toronto Hydro's view is that there is a reasonable probability that the current balance in the account will be substantially reduced without the necessity of funding from ratepayers and hence, it is not requesting disposition of the account at this time.<sup>32</sup>

There were no objections to Toronto Hydro's request not to dispose of this account at this time.

The OEB accepts Toronto Hydro's request.

## **LRAMVA**

### **Background**

The total amount claimed by Toronto Hydro for CDM activities in 2011, 2012 and 2013 is \$3,452,615, plus carrying charges of \$99,759 for which recovery was requested through a 12-month rate rider. Toronto Hydro stated that an application for the 2014 LRAMVA amount would be submitted at a later date.

Toronto Hydro confirmed that it would not be submitting an application to recover LRAM amounts related to 2008, 2009 and 2010 consistent with the OEB's CDM Guidelines.

Toronto Hydro noted that its load forecast for 2011 did not include an explicit amount for CDM savings as CDM was accounted for through the trend variables in the customer class regression. Therefore, in order to determine the amount of CDM implicitly embedded in the trend variables used in the 2011 load forecast, which is the basis for the LRAMVA calculations, Toronto Hydro estimated a relationship between the actual historical CDM savings and the trend variables used in the forecast models for each rate class.

With respect to the actual CDM savings for 2011, 2012 and 2013, Toronto Hydro relied on the most recent evaluation report from the Ontario Power Authority (OPA) – the 2013 OPA draft verified results report - in support of its LRAMVA calculations.

OEB staff commented that Toronto Hydro's approach to its LRAMVA calculations is a more precise approach than the standard one but is not inconsistent with it, so the results should be accepted.

The OEB agrees and will approve Toronto Hydro's proposal.

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<sup>32</sup>EB-2014-0116 IRR 9-OEBStaff-86

### **3.24 Rate Riders (Issue 4.4)**

Toronto Hydro's proposed rate riders were generally accepted by parties, with the exception of the rate rider to allow for the recovery of lost revenue associated with the IRM framework in the 2012 to 2014 period, which OEB staff and most intervenors opposed as a form of retroactive rate-making.

The OEB denies Toronto Hydro's request for the lost 2012 to 2014 revenue recovery rate rider.

The OEB agrees with OEB staff that Toronto Hydro's request for the recovery of this amount would be a form of retroactive rate-making. The OEB made a finding in EB-2012-0064 that it would not approve a departure from the usual policy with respect to averaging of rate base and the use of the half-year rule for depreciation, and that rate base is not adjusted during the term of the IRM. This was consistent with the OEB's policy not to allow for recovery of forgone amounts related to the implementation of the half year rule when a utility rebases. The full amount of depreciation expense for the related assets is only included in base rates going forward.

Had the OEB intended that Toronto Hydro would be permitted to request recovery of this amount in a future cost of service application, the OEB would have established a deferral account to record these amounts. It did not do so.

The OEB approves Toronto Hydro's other proposed rate riders.

#### **Rate Implementation**

### **3.25 Toronto Hydro's proposal to implement Rate and Fiscal Year Synchronization (Issue 7.1)**

#### **Background**

Toronto Hydro is seeking approval to align its Rate Year with its Fiscal Year effective January 1, 2016. Rates for 2015, its rebasing year, are proposed to be effective May 1, 2015. Rates for the first year under the proposed Price Cap would be effective January 1, 2016. Toronto Hydro confirmed that it was not requesting any special treatment for the calculation of 2015 rates (i.e., it is not calculating rates based on recovering the full year of revenue requirement over an eight-month May to December period). Toronto Hydro submitted that neither its customers nor the utility are harmed by this proposed change in rate year.

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## Findings

The OEB accepts Toronto Hydro's proposal for rate synchronization effective January 1, 2016.

The OEB notes that the RRFE contemplates a five year Custom IR plan period and that there were some concerns expressed by intervenors that with alignment to the January 1 rate year, the application falls short of five years as it only covers the period from May 1, 2015 to December 31, 2019, which is four years and eight months

The OEB agrees that this is technically true, but considers that Toronto Hydro's application meets the critical elements of a Custom IR application. In addition, the four month shortfall is not substantially short of the five year requirement and is justified by the one-time transition to the January 1, 2016 rate year.

The OEB accordingly approves the requested rate year realignment.

## Effective Date

The OEB has determined that rates will be effective May1, 2015 in keeping with Toronto Hydro's proposal. Intervenors were largely supportive of this request. The OEB has determined 2015 rates on the basis of the revenue requirement necessary for 2015 and therefore will not reduce this amount by ordering a different effective date than the one contemplated in the Application.

## 3.26 Previous Board Directives (Issue 1.1)

### Background

Toronto Hydro identified<sup>33</sup> in its evidence previous OEB directives and undertakings and how these were being addressed in the application. These directives included the following:

1. File a cost allocation model that will disaggregate meter reading costs appropriately into Account 5310.
2. Review each of the assumptions set out in the decision and order when its cost allocation study is refreshed for its next cost of service application.
3. Provide external evidence related to productivity and capital planning in the next cost of service application.
4. Provide seminar on Feeder Investment Model (FIM) to Intervenors before filing 2015 application.

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<sup>33</sup> EB-2014-0116 Application E 1A/T3/S1/p. 5.

5. Use best efforts to track any assets taken out of service before the end of their useful lives associated with the completion of ICM work segments approved in Phase 2 of this proceeding.
6. Evaluate options to measure or estimate actual line losses and the impacts on Account 1588 balances in accordance with the Accounting Procedures Handbook. File the results in its application for 2015 rates.

## Findings

The OEB is satisfied that Toronto Hydro has responded to all relevant OEB directions. This issue was not contested by the parties.

### 3.27 Do any of Toronto Hydro's proposed rates require rate smoothing?

#### Background

The OEB's Filing Requirements<sup>34</sup> state that "A distributor must file a mitigation plan if total bill increases for any customer class exceed 10%."

Toronto Hydro has not proposed a mitigation plan for the rate classes exceeding the 10% threshold in 2016.

#### Findings

Subject to the OEB's comments on the foregone revenue rate rider below, the OEB will not require rate smoothing. The OEB recognizes that any increase in rates has an impact on customers and is mindful of the concerns expressed by some intervenors that the magnitude of the proposed increases would justify rate smoothing.

However, the OEB has established a threshold at which point the applicant must undertake rate smoothing. Toronto Hydro's proposed rates do not meet that threshold. The OEB has also not approved the entire rate increase applied for by Toronto Hydro. This will consequently lead to lower rate impacts.

In this Decision, the OEB is approving foregone revenue rate riders for the May 1, 2015 to February 29, 2016 period. Toronto Hydro shall assess any additional impacts from the application of these riders and shall propose a mitigation plan if required.

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<sup>34</sup> Ontario Energy Board *Filing Requirements for Electricity Distribution Rate Applications -2014 Edition for 2015 Rate Applications*, Ch 2/pp. 58-59.

## 4 IMPLEMENTATION

New rates for 2015 are to be effective May 1, 2015 and implemented on March 1, 2016. New rates for 2016 are to be effective January 1, 2016 and implemented on March 1, 2016. Toronto Hydro must calculate a rate rider to be applied to 2016 rates that recovers the revenue that Toronto would have recovered in rates from May 1, 2015 to December 31, 2015 (consistent with the findings in this Decision). Toronto Hydro shall file a schedule showing the calculation of the rate rider and its consistency with the 2015 draft rate order. In addition, Toronto Hydro must calculate a rate rider to be applied to 2016 rates that recovers the revenue that Toronto Hydro would have recovered in rates from January 1, 2016 to February 29, 2016 consistent with the findings in this Decision. Toronto Hydro shall file a schedule showing the calculation of the rate rider and its consistency with the 2016 draft rate order.

As indicated in rate design section of this Decision, the OEB expects that the draft rate orders submitted by Toronto Hydro for 2017, 2018 and 2019 will contain a proposal for the transition to fully fixed residential rates. If applicable, Toronto Hydro must show how it has considered mitigation for low volume customers consistent with approach outlined in section 2.8.13 of Chapter 2 of the OEB's *Filing Requirements for Electricity Distribution Rate Applications (2015 Edition)*.

The rates for 2017, 2018 and 2019 are approved on an interim basis, and the rate order and tariff sheets for those years must indicate this status in the title of the document.

In addition to its findings on the proposed Settlement Agreement, the OEB is making provision for the following three matters to be incorporated into Toronto Hydro's Tariff of Rates and Charges.

### **Rural or Remote Electricity Rate Protection Charge**

The Rural or Remote Electricity Rate Protection (RRRP) program is designed to provide financial assistance to eligible customers located in rural or remote areas where the costs of providing electricity service to these customers greatly exceeds the costs of providing electricity to customers located elsewhere in the province of Ontario. The RRRP program cost is recovered from all electricity customers in the province through a charge that is reviewed annually and approved by the OEB.

### **Wholesale Market Service Rate**

Wholesale market service (WMS) charges recover the cost of the services provided by the Independent Electricity System Operator (IESO) to operate the electricity system and administer the wholesale market. These charges may include costs associated

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with: operating reserve, system congestion and imports, and losses on the IESO-controlled grid. Individual electricity distributors recover the WMS charges from their customers through the WMS rate.

### **Ontario Electricity Support Program**

The Ontario Electricity Support Program (OESP) is a new rate assistance program for low-income electricity customers. Starting January 1, 2016, eligible low-income customers will receive a monthly credit on their bills. At the same time, all electricity customers in the province will begin paying a charge to fund the program, which will be referred to as the OESP charge.

These regulatory charges are established annually by the OEB through a separate order.

The OEB issued its Decision and Rate Order for the RRRP, WMS and OESP charges on November 19, 2015. The Tariff of Rates and Charges flowing from this Decision and Order should reflect these new charges.

## 5 ORDER

### THE ONTARIO ENERGY BOARD ORDERS THAT:

1. Toronto Hydro-Electric System shall file with the OEB, and shall also forward to the Intervenor, a draft rate order attaching a proposed Tariff of Rates and Charges for 2015-2019, reflecting the OEB's findings in this Decision and the Wireless Settlement decision and order and draft accounting orders for the eight approved deferral and variance accounts, by **January 22, 2016**. The draft rate orders shall also include:
  - For each year, customer rate impacts resulting from the implementation of this Decision and supporting information showing the calculation of the rates
  - For each year, a completed version of the Revenue Requirement Work Form excel spreadsheet, which can be found on the OEB's website
  - For 2015, the calculation of the rate rider to be applied during 2016 to recover revenue that would have been recovered in rates from May 1, 2015 to December 31, 2015
  - For 2016, the calculation of the rate rider to be applied during 2016 to recover revenue that would have been recovered in rates from January 1, 2016 to February 29, 2016
  - For 2017, 2018 and 2019, a proposal for the first three years of the transition to fully fixed residential rates, with a schedule for each of these years showing the year-over-year change to the monthly fixed charge and the combined bill impact of the transition to fixed rates and other changes resulting from this Decision, for a low-volume customer as discussed in section 2.8.13 of Chapter 2 of the OEB's *Filing Requirements for Electricity Distribution Rate Applications (2015 Edition)*.
2. OEB staff and Intervenor shall file any comments on the draft rate order with the OEB, and forward the comments to Toronto Hydro on or before **February 5, 2016**.
3. Toronto Hydro shall file with the OEB and forward to the intervenors responses to any comments on its draft rate order on or before **February 12, 2016**.

All filings to the OEB must quote the file number, EB-2014-0116, be made in searchable / unrestricted PDF format electronically through the OEB's web portal at

<https://www.pes.ontarioenergyboard.ca/eservice/>. Two paper copies must also be filed at the OEB's address provided below. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at <http://www.ontarioenergyboard.ca/OEB/Industry>. If the web portal is not available parties may email their documents to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

All communications should be directed to the attention of the Board Secretary at the address below, and be received no later than 4:45 p.m. on the required date.

With respect to distribution lists for all electronic correspondence and materials related to this proceeding, parties must include the Case Manager, Martin Davies at [Martin.Davies@ontarioenergyboard.ca](mailto:Martin.Davies@ontarioenergyboard.ca) and OEB Counsel, at [Maureen.Helt@ontarioenergyboard.ca](mailto:Maureen.Helt@ontarioenergyboard.ca).

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**DATED** at Toronto, **December 29, 2015**

## ONTARIO ENERGY BOARD

*Original Signed By*

Kirsten Walli  
Board Secretary