EB-2012-0064

IN THE MATTER OF the *Ontario Energy Board Act 1998*, Schedule B to the *Energy Competition Act*, 1998, S.O. 1998, c.15;

AND IN THE MATTER OF an Application by Toronto Hydro-Electric System Limited for an Order or Orders approving just and reasonable rates and other service charges for the transmission of electricity, effective June 1, 2012, May 1, 2013, and May 1, 2014.

CROSS-EXAMINATION COMPENDIUM
OF THE SCHOOL ENERGY COALITION
(Panel 3)

December 13, 2012

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December 7, 2012

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, Suite 2700
Toronto ON
M4P 1E4

Dear Madame:

Re: Renewed Regulatory Framework for Electricity Report (the "Report")
Board File No.: EB-2010-0377; EB-2010-0378; EB 2010-0379; EB-2011-0043 and EB-2011-0004

Introduction

This letter is written in my capacity as Chair of the Distribution Regulation Review Task Force (the "Task Force"). The Task Force is an initiative of the leading gas and electricity distribution utilities in Ontario aimed at encouraging thought and discussion on how the Ontario Energy Board's ("OEB" or the "Board") approach to regulating energy distribution can be enhanced. These utilities are: Enersource Hydro Mississauga Inc., Horizon Utilities Corporation, Hydro Ottawa Limited, PowerStream Inc., Toronto Hydro-Electric System Limited, and Veridian Connections Inc., Enbridge Gas Distribution Inc., Hydro One Networks Inc., and Union Gas Limited.

The Task Force has supported and participated in all stages of the Board's consultations respecting the Renewed Regulatory Framework for Electricity Distributors and Transmitters ("RRFE") and attended the Board's Information Session on October 31, 2012.

In the Task Force's view, the RRFE was necessary to address the most pressing need in the sector – an improved approach to the rate treatment of investment required for infrastructure renewal. As the Chair of the OEB has observed, "one of the major challenges facing the sector today and the most significant driver of costs is the scale of capital spending expected over the next few years from most utilities – generators, transmitters and distributors alike – to renew and modernize the system and provide for new demand."[1]

The Task Force appreciates that the Board has established Working Groups to further develop the implementation framework for the three options, and its members look forward to providing constructive input to that process. Nevertheless, there does not appear to be a specific process aimed at addressing a particularly important but still outstanding issue, that is, the treatment of infrastructure investment in the Incremental Capital Module ("ICM") within the context of the 4th Generation Incentive Regulation Mechanism ("4th Generation IRM").

The Task Force therefore requests that the Board provide a forum where stakeholders can specifically engage in discussions respecting the ICM criteria, and how they can be interpreted and applied. This can be addressed within the context of current ICM applications (i.e., by treating their outcomes as resolving industry wide generic issues) or through a working group process that can lead to a supplemental report.

The Need for Clarity for 4th Generation IRM

In different decisions, reports and guidelines, the Board has applied a number of different criteria for an investment to qualify for Incremental Capital Module ("ICM"); these are:

- "Materiality, Need and Prudence"[2]
- "Materiality, Need and Prudence", **plus** "extraordinary and unanticipated"[3]
- Materiality, Need and Prudence", **plus** "extraordinary"[4]
- "Applicants must demonstrate that the amounts exceed the Board's materiality threshold and clearly have a significant influence on the operation of the distributor, must be clearly non-discretionary and the amounts must be outside the base upon which rates were derived. In addition, the decision to incur the amounts must represent the most cost-effective option for ratepayers."[5]
- "Discrete, Material and non-discretionary" and, apparently, facility specific.[6]

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1 Rosemarie T. Leclair, Chair & CEO, Ontario Energy Board, Remarks for the Ontario Energy Network, November 21, 2011, p. 7.

2 Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, July 14, 2008, s. 2.5; see also, Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, September 17, 2008, Appendix B.

3 Hydro One Networks Inc. Decision, May 13, 2009 (EB-2008-0187).

4 Oshawa PUC Decision, June 10, 2009 (EB-2008-0205).

5 Guelph Hydro Electric System Inc., Decision, May 13, 2009 (EB-2010-0130 (corrected)) June 10, 2009; and Oakville Hydro Electricity Distribution Inc., Decision (EB-2010-0104), June 10, 2009.

6 Toronto Hydro-Electric System Limited (EB-2011-0144), Decision, January 5, 2012. The decision referred to the fact that municipal transformer stations have been funded through ICM and suggested that an IRM application that requested

These different approaches have left all parties with considerable uncertainty as to how the ICM criteria will be interpreted and applied. As a result of this uncertainty, the Task Force – whose members are responsible to make necessary investments in infrastructure renewal - requested that the Board conduct a specific process to bring clarity and direction to this important issue.

Unfortunately, the Report did not provide specific direction in this regard. Instead, the Report referred to another Board document – the *Filing Requirements for Electricity Transmission and Distribution Applications* (the "Filing Requirements"). The entire treatment of this issue in the Report is as follows:[7]

> "In the Filing Requirements issued in June 2012, the ICM was further revised to remove words such as 'unusual' and 'unanticipated' as prerequisites to an application for incremental capital, although the requirement that the proposed expenditures be non-discretionary remains."

With respect, this statement raises as many questions as it answers.

First, the reference to the Filing Guidelines does not provide a clear statement of OEB policy and does not provide assurance as to what criteria a panel will apply. The Filing Guidelines only set out minimum evidentiary requirements that must be filed to support an application. They are expressly not a statement of OEB Policy; indeed, they provide that they do "not preempt the Board's discretion to make any order or directive as it determines necessary concerning any of the matters raised by the applications filed."[8]

Second, even if the Filing Guidelines did clarify *which* criteria will apply, it is still necessary to clarify *how* a specific criterion will be interpreted and applied. Of particular concern is the Report's reliance on the term "non-discretionary" to describe the spending that can qualify for ICM treatment. That term is open to a number of different meanings. In the context of transmission investments, the Board has provided at least some illustrations of projects that may be considered "discretionary" and "non-discretionary".[9] However, even that limited level of guidance is not provided for distribution investments.

Conclusion

The Task Force therefore requests that the Board provide a forum where stakeholders can specifically engage in discussions respecting the fundamental ICM criteria, and how they can be interpreted and applied. This can be addressed within the context of current ICM applications (i.e., by treating their outcomes as resolving industry wide generic issues) or through a working group process that can lead to a supplemental report.

Further, the Report provides that the term of the 4th Generation IRM should be extended to 5 years (rebasing plus 4 years). This term extension is extremely challenging because it defers the

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funding for similar facilities would be "directly analogous to projects that the Board has previously approved under ICM for other distributors." (at p. 22).

7 Report, p. 18.

8 Filing Guidelines, pp. 1-2.

9 Filing Guidelines, pp. 9-10.

period of rebasing – particularly in relation to rate base additions. This leads to greater uncertainty over cost recovery and increased step change rate adjustments upon rebasing. This challenge is exacerbated by the uncertainty with respect to the ICM.

Although this issue was floated by some participants in the consultation process, it is fair to say that there was not a detailed consideration of the costs and benefits of this approach. The Task Force therefore respectfully requests that the appropriate term of the 4th Generation IRM be an issue for further consultation.

Sincerely,

signed in the original

George Vegh,

Chair, Distribution Regulation Review Task-Force

c: Norm Ryckman, Michael Lister – Enbridge Gas Distribution Inc.
Gia DeJulio – Enersource Hydro Mississauga Inc.
Indy Butany-DeSouza – Horizon Utilities Corporation
Ian Malpass – Hydro One Networks Inc.
Jane Scott, Patrick Hoey – Hydro Ottawa Limited
Colin Macdonald, Sarah Griffiths – PowerStream Inc.
Colin McLorg – Toronto Hydro Electric System Limited
Mark Kitchen – Union Gas Limited
George Armstrong – Veridian Connections Inc.

d. Updated Budget

Oakville Hydro's updated budget, excluding the Harmonized Sales Tax, is provided in the following table. The capital contribution represents the amount payable to Hydro One to design, construct and operate a new double circuit line to Oakville Hydro's new transformer station in North Oakville. These costs include an estimate of capitalized interest expense of $710,667. This estimated is based upon a proposed financing agreement with Infrastructure Ontario for a loan in the amount of $20M to be financed at a rate of 5.33% over 20 years. This rate is subject to change as it is updated daily.

Capital Spending
North Oakville Transformer Station

Component	2009 Actual	2010 Bridge Year	2011 Test Year	Total
Substation Equipment	41,318	1,153,895	953,200	2,148,412
TS Switchgear - Gas	105,695	2,881,682	138,277	3,125,654
TS Transformer	279,321	3,713,203	4,323,241	8,315,765
Revenue Meters	14,828	288,960	159,148	462,936
SCADA & DC Systems	4,542	100,722	29,108	134,371
UG Cable	-	193,930	93,198	287,128
Duct & Civil	-	1,150,275	552,791	1,703,066
Building	-	1,792,250	861,221	2,653,470
Land	-	1,367,700	49,786	1,417,486
Capital Contribution	-	120,200	120,000	240,200
Total	**445,703**	**12,762,816**	**7,279,970**	**20,488,489**

GUELPH MTS#1 BUDGET SUMMARY

		Projected	2009 Actuals	2010 Actuals	2010 Projected	2011 Budget
1.0	**Property**					
		$ 1,915,825	$ -	$ 1,915,825	$ 1,915,825	$ -
2.0	**Engineering & Environmental**					
		$ 1,214,268	$ 140,180	$ 243,727	$ 566,227	$ 507,861
3.0	**Major Equipment**					
		$ 5,970,620	$ -	$ -	$ 965,488	$ 5,005,131
4.0	**Construction and Commissioning**					
		$ 5,000,000	$ -	$ -	$ -	$ 5,000,000
5.0	**Transmission Line Connection**					
		$ 494,000	$ -	$ -		$ 494,000
6.0	**Feeder Egress**					
		$ 250,000	$ -	$ -		$ 250,000
	Less Contributed Capital					
		$ (400,000)				$ (400,000)
	TOTAL	$ 14,444,713	$ 140,180	$ 2,159,552	$ 3,447,540	$ 10,856,993
						$ 14,444,713

ORAL HEARING UNDERTAKING RESPONSE
INTERVENOR 10 – SCHOOL ENERGY COALITION

UNDERTAKING NO. J2.1:

Reference(s):

Using the Summary of Capital Program for the capital expenditure by segment, THESL to provide the In-Service Addition (ISA) for each of the respective years.

RESPONSE:

Please see Table 1 in attached Appendix A, for details on ISAs.

THESL had $177.01 million of expenditures not in-service from previous years. This amount was for jobs not completed in full from previous years, mainly from 2011. There are a number of reasons for these jobs not being completed, including:

- For operational efficiency, jobs must be scheduled throughout a calendar year, such that some jobs naturally span the end of one year and the start of the next.
- Jobs often span more than one calendar year from the beginning of design to the completion of construction.
- Many jobs, while substantially complete, still require final work such as pole removals and site restoration which delay final completion into the next year, once winter has passed and this work can be done.

THESL is projecting for the end of 2012 to have lower than typical in-service expenditures. This is due to the stoppage of the capital program in January 2012 following the OEB decision in EB-2011-0144, and the operational factors associated with the ramp-up in work. This ramp-up pushed much of the capital work into the latter half of the year, and especially the last quarter, which has led to a greater amount of work

ORAL HEARING UNDERTAKING RESPONSE
INTERVENOR 10 – SCHOOL ENERGY COALITION

than usual carrying into 2013. THESL's projection of ISA for 2012 includes the following:

- $67.0M – pre-2012 CWIP
- $116.3M – 41% of 2012 capital expenditures
- **$183.3M** total ISA

For 2013, THESL expects to have approximately 49% of the overall capital expenditures in-service by year-end. Excluding the Bremner Transformer Station and Hydro One capital contributions, THESL forecasts to have approximately 61% of 2013 capital expenditures to be in-service by year-end, which is more consistent with years prior to 2012. THESL's projection of ISA for 2013 includes the following estimates:

- $45.5M – pre-2012 CWIP
- $140.6M – 50% of 2012 capital expenditures
- $283.8M – 49% of 2013 capital expenditures
- **$469.8M** total 2013 ISA

For 2014, THESL expects to have the residual 2013 capital expenditures to be in-service, as well as the Bremner Transformer Station and Hydro One capital contributions from the two preceding years. THESL's projection of ISA for 2014 includes the following estimates:

- $32.3M – pre-2012 CWIP
- $26.1M – 9% of 2012 capital expenditures (Bremner & Hydro One capital contributions)
- $295.3M – 51% of 2013 capital expenditures (inclusive of Bremner & Hydro One capital contributions)
- **$353.7M** total 2014 ISA (not including 2014 capital expenditures)

In-Service Summary of Capital Program

			2012 Cost Estimates ($M)						2013 Cost Estimates ($M)				
Schedule Number	Projects	Segments	2012 Forecast	2012 Additions (In-Service)		2012 Additions (Not In-Service)	Forecast 2013 In-Service for 2012 Carryforward	Forecast 2014 In-Service for 2012 Carryforward	2013 Budget	2013 Additions (In-Service)		2013 Additions (Not In-Service)	Forecast 2014 In-Service for 2013 Carryforward
B1		Underground Infrastructure	28.75	12.74		16.01	16.01	-	58.94	35.87		23.07	23.07
B2	Underground Infrastructure and Cable	Paper Insulated Lead Covered Cable - Piece Outs and Leakers	0.08	0.04		0.05	0.05	-	5.42	3.30		2.12	2.12
B3		Handwell Replacement	13.65	6.05		7.60	7.60	-	16.65	10.13		6.52	6.52
B4		Overhead Infrastructure	9.07	4.02		5.05	5.05	-	55.88	34.01		21.87	21.87
B5		Box Construction	0.58	0.26		0.32	0.32	-	23.04	14.02		9.02	9.02
B6	Overhead Infrastructure and Equipment	Rear Lot Construction	16.36	7.25		9.11	9.11	-	29.43	17.91		11.52	11.52
B7		Polymer SMD-20 Switches	-	-		-	-	-	1.53	0.93		0.60	0.60
B8		SCADA-Mate R1 Switches	-	-	44%	-	-	-	1.43	0.87	61%	0.56	0.56
B9		Network Vault & Roofs	2.84	1.26		1.58	1.58	-	18.76	11.42		7.34	7.34
B10	Network Infrastructure and Equipment	Fibertop Network Units	1.48	0.65		0.82	0.82	-	7.71	4.69		3.02	3.02
B11		Automatic Transfer Switches (ATS) & Reverse Power Breakers (RPB)	-	-		-	-	-	3.26	1.99		1.28	1.28
B12		Stations Power Transformers	0.38	0.17		0.21	0.21	-	3.48	2.12		1.36	1.36
B13.1 & 13.2		Stations Switchgear - Muncipal and Transformer Stations	1.73	0.77		0.96	0.96	-	21.81	13.28		8.54	8.54
B14	Station Infrastructure and Equipment	Stations Circuit Breakers	0.76	0.34		0.42	0.42	-	0.55	0.34		0.22	0.22
B15		Stations Control & Communicaton Systems	0.14	0.06		0.08	0.08	-	1.00	0.61		0.39	0.39
B16		Downtown Station Load Transfers	0.68	0.30		0.38	0.38	-	2.14	1.30		0.84	0.84
B17	Bremner TS	Bremner Transformer Station	8.50	-	0%	8.50		8.50	81.00	-	0%	81.00	81.00
B18	Hydro One Capital Contributions	Hydro One Capital Contributions	22.98	3.69	16%	19.28	1.68	17.60	48.12	9.02	19%	39.10	39.10
B19	Feeder Automation	Feeder Automation	2.30	1.02		1.28	1.28	-	20.66	12.58		8.09	8.09
B20	Metering	Metering	4.74	2.10		2.64	2.64	-	8.40	5.11		3.29	3.29
B21	Plant Relocations	Externally-Initiated Plant Relocations and Expansions	10.16	4.50	44%	5.66	5.66	-	24.84	15.12	61%	9.72	9.72
B22	Grid Solutions	Grid Solutions	-	-		-	-	-	-	-		-	-
BXX	Engineering Capital	ICM Understatement of Capitalized Labour	8.32	3.69		4.63	4.63	-	-	-		-	-
C1	Operations Portfolio Capital		120.51	53.95		66.56	66.56	-	121.63	77.44		44.20	44.20
C2	Information Technology Capital		22.00	9.25		12.75	12.75	-	15.00	8.72		6.28	6.28
C3	Fleet Capital		0.80	0.29	47%	0.51	0.51	-	2.00	0.25	54%	1.75	1.75
C4	Buildings and Facilities Capital		5.00	3.76		1.24	1.24	-	5.00	1.65		3.35	3.35
	Allowance for Funds Used During Construction		1.20	0.15		1.05	1.05	-	1.40	1.09		0.31	0.31
Total			**283.00**	**116.31**		**166.69**	**140.59**	**26.10**	**579.09**	**283.76**		**295.33**	**295.33**
Percentage In-Service Additions				**41%**			**50%**	**9%**		**49%**			**51%**

	2012 Forecast	2013 Budget
Cost Estimates ($M)	283.00	579.09
In-Service Additions	116.31	283.76
Total	**41.1%**	**49.0%**

Total	2012 ISA	2013 ISA	2014 ISA	2015 ISA	Total
2012 Capital Expenditure	116.31	140.59	26.10		**283.00**
2013 Capital Expenditure		283.76	295.33		**579.09**
pre-2012 CWIP	67.00	45.46	32.28	32.28	**177.01**
Total	**183.30**	**469.81**	**353.71**	**32.28**	-

Addendum to Manager's Summary – Summary of Updated Evidence

1. Introduction

This evidence update is filed pursuant to section 11.02 of the OEB's Rules of Practice and Procedure.

On September 13 and October 22, 2012, THESL advised the OEB and parties by letter that since much of 2012 has passed, THESL had undertaken a process to update its evidence to reflect the necessary rescheduling of the jobs constituting its proposed capital program, together with other consequential changes.

This summary describes the nature and underlying rationale for THESL's evidentiary update in respect of 2012 and 2013. THESL's proposal for 2014 is described in further detail below.

As described in its October 22, 2012 letter, THESL's update is fundamentally administrative in nature, representing a shifting of certain jobs between ICM years in order to reflect the reality of the passage of time in 2012 and THESL's operational experience since this application was filed in May. The movement of jobs from 2012 to 2013 is also partially a result of the limited funds available for 2012 capital expenditures as well as other factors discussed in greater detail later in this summary. THESL has also taken the opportunity to update certain forecast information that has recently become available. THESL provides this update to assist in providing the OEB and intervenors a more precise picture of its capital needs, and where possible for 2012, THESL has replaced forecasts with actuals.

THESL sees the Incremental Capital Module as a regulatory instrument which allows for the funding of necessary capital expenditures in a context where there is no other mechanism available for funding those expenditures. These are the precise circumstances in which THESL finds itself – THESL presently has no other option to fund this essential work.

THESL believes that the workplan described in this update conforms to the requirements and intent of the incremental capital module as it has evolved over time, including the relevant ICM factors, such as need and prudence.

All of THESL's work under an approved ICM will be subject to a true-up mechanism to be applied at the time of rebasing. THESL is committed to developing a true-up protocol which meets all of the Board's requirements. As discussed below, if the Board considers it advisable, THESL will work with Board Staff and Intervenors to develop such a protocol.

2. Phasing Request, Urgency and Proceeding Timelines

As requested through its counsel in the covering letter accompanying this update, while THESL maintains its three year request for ICM funding, it is proposing, with one exception, that 2014 be bifurcated from the 2012 and 2013 portions of the application and considered by the OEB in a second phase to be heard after a decision for 2012 and 2013.

The sole exception to THESL's bifurcation request is the Bremner project together with the Bremner-related capital contributions to Hydro One.

In order to provide THESL ratepayers with certainty concerning rates to be effective in 2013, and to address critically needed capital work on its distribution system, THESL believes that phase 1 of the application must be heard as expeditiously as possible and in 2012. THESL proposes that bifurcating and phasing this application will assist the OEB and all parties in addressing the 2012 and 2013 issues more effectively and expeditiously.

THESL believes that the suite of capital work proposed is essential for maintaining the reliability of the distribution system for customers and the safety of employees and the public. To this end, THESL has undertaken the difficult task of balancing the need to undertake certain capital work in 2012 with the present lack of rates funding to do that work. THESL forecasts that it will have spent a considerable amount of money beyond

Table 2: Overall Cost Impacts by ICM Segment

$Millions

Projects	Segments	2012 Original Cost	2012 Update Cost	Update - Original Variance	2013 Original Cost	2013 Update Cost	Update - Original Variance	2014 Original Cost	2014 Update Cost	Update - Original Variance	Total Original Cost	Total Update Cost	Update - Original Variance
Underground Infrastructure and Cable	Underground Infrastructure	46.9	28.8	(18.2)	53.0	58.9	5.9			-	100.0	87.7	(12.3)
	Paper Insulated Lead Covered Cable - Piece Outs and Leakers	17.3	0.1	(17.2)	5.2	5.4	0.2			-	22.5	5.5	(17.0)
	Handwell Replacement	12.0	13.7	1.6	14.5	16.7	2.2			-	26.5	30.3	3.8
Overhead Infrastructure and Equipment	Overhead Infrastructure	29.4	9.1	(20.4)	53.0	55.9	2.9			-	82.4	64.9	(17.5)
	Box Construction	10.2	0.6	(9.6)	20.5	23.0	2.5			-	30.7	23.6	(7.1)
	Rear Lot Construction	34.4	16.4	(18.0)	20.7	29.4	8.7			-	55.1	45.8	(9.3)
	Polymer SMD-20 Switches	3.1	-	(3.1)	2.9	1.5	(1.4)			-	6.0	1.5	(4.5)
	Scadamate R1 Switches	2.9	-	(2.9)	2.8	1.4	(1.4)			-	5.7	1.4	(4.2)
Network Infrastructure and Equipment	Network Vault and Roofs	13.6	2.8	(10.7)	12.3	18.8	6.5			-	25.9	21.6	(4.3)
	Fibertop Network Units	8.6	1.5	(7.1)	8.8	7.7	(1.1)			-	17.4	9.2	(8.2)
	Automatic Transfer Switches and Reverse Power Breakers	3.3	-	(3.3)	3.3	3.3	(0.0)			-	6.6	3.3	(3.3)
Station Infrastructure and Equipment	Stations Power Transformers	1.3	0.4	(0.9)	2.6	3.5	0.9			-	3.9	3.9	-
	Stations Switchgear - Municipal and Transformer Stations	19.3	1.7	(17.6)	18.8	21.8	3.1			-	38.1	23.5	(14.6)
	Stations Circuit Breakers	1.4	0.8	(0.6)	1.1	0.6	(0.5)			-	2.4	1.3	(1.1)
	Stations Control and Communication Systems	1.1	0.1	(1.0)	2.2	1.0	(1.2)			-	3.3	1.1	(2.2)
	Downtown Station Load Transfers	1.8	0.7	(1.1)	1.6	2.1	0.6			-	3.3	2.8	(0.5)
Bremner Transformer Station	Bremner Transformer Station	31.7	8.5	(23.2)	69.4	81.0	11.6	23.0	34.6	11.6	124.1	124.1	(0.0)
Hydro One Capital Contributions	Hydro One Capital Contributions	25.3	23.0	(2.3)	52.1	48.1	(4.0)	27.0	37.0	10.0	104.4	108.1	3.7
Feeder Automation	Feeder Automation	7.8	2.3	(5.5)	16.3	20.7	4.4			-	24.1	23.0	(1.2)
Metering	Wholesale and Smart Metering	5.6	4.7	(0.9)	7.2	8.4	1.2			-	12.8	13.1	0.3
Plant Relocations	Externally-Initiated Plant Relocations and Expansions	24.3	10.2	(14.1)	17.7	24.8	7.2			-	41.9	35.0	(6.9)
Grid Solutions	Grid Solutions	2.4	-	(2.4)	3.6	-	(3.6)			-	6.0	-	(6.0)
Total ICM		303.6	125.2	(178.5)	389.5	434.1	44.6	50.0	71.6	21.6	743.1	630.8	(112.3)

Note: Hydro One Capital Contribution figures for 2014 reflect Bremner-related amounts only. Updated amount for 2012 Hydro One Capital Contributions reflects a credit amount from a prior period, unrelated to proposed ICM projects.

For clarity regarding the total costs of jobs, segments, and projects, THESL has classified jobs according to the year of their commencement, recognizing that in many cases 2012 jobs will now be carried over into 2013. Costs stated in the business cases follow this protocol.

EB-2012-0136

SETTLEMENT AGREEMENT

Hydro One Networks Inc.
2013 Distribution Rates

December 10, 2012

E1-2-1	Rate Rider Calculations
E1-2-1 App. A	2012 IRM 3 Tax Savings Workform
E1-3-1	Customer Bill Impact Summary
E2-1-1	2013 OEB 3GIRM Filing Module Output Sheets
E2-3-1	Customer Impacts
I-1-1.01 Staff 1	OEB Interrogatory #1
I-1-2.01 EP 1	Energy Probe Interrogatory #1
I-1-5.01 VECC 1	VECC Interrogatory #1
I-1-5.02 VECC 2	VECC Interrogatory #2
I-1-5.03 VECC 3	VECC Interrogatory #3
I-1-6.01 PWU 1	PWU Interrogatory #1
I-1-7.01 CCC 1	CCC Interrogatory #1
I-1-7.02 CCC 2	CCC Interrogatory #2
I-1-7.03 CCC 3	CCC Interrogatory #3
I-1-7.04 CCC 4	CCC Interrogatory #4
TCR VECC 01	VECC Technical Conference Response #1
TCR SEC 02	SEC Technical Conference Response #2
TCR SEC 04	SEC Technical Conference Response #4
TCR SEC 05	SEC Technical Conference Response #5
TCR SEC 05.1	SEC Technical Conference Response #5.1
TCR SEC 07	SEC Technical Conference Response #7
TCR SEC 08	SEC Technical Conference Response #8
TCR CCC 01	CCC Technical Conference Response #1
TCR CCC 02	CCC Technical Conference Response #2
TCR CCC 03	CCC Technical Conference Response #3
TCR VECC 03	VECC Technical Conference Response #3
TCR VECC 08	VECC Technical Conference Response #8
JTC1	Undertaking Response #1
JTC4	Undertaking Response #4
JTC5	Undertaking Response #5
JTC6	Undertaking Response #6

Supporting Parties: AMPCO, BLC, CME, CCC, EP, FOCA, OFA, PWU, SEC, VECC

Parties taking no position:

INCREMENTAL CAPITAL MODULE/RATE RIDER

2. Should the proposed capital projects be approved for ICM treatment?

Settled. For the purposes of reaching a settlement, the parties agree that only projects that are incremental to depreciation plus the 20% deadband, as calculated in accordance with the Board's formula, qualify for ICM treatment. The parties agree that Hydro One will update the threshold calculation for the Board's revised inflation factor. The revised calculation raised the threshold from $332.5M to $342.4M.

For the purposes of reaching a settlement, the parties agree that the phrase "Typical Capital" implies that it represents projects that are "business as usual", which is inappropriate for ICM treatment.

The parties agree that the in-service additions of the following projects should be approved for ICM treatment. In so doing, the agreed projects that were in the category described as "Typical Capital" in the pre-filed evidence have been reviewed and placed in a new category, "Special Capital" in this Settlement Agreement. The projects listed under that category are those that, in the particular circumstances of the Applicant in the Test Year, the parties agree are sufficiently out of the normal course of business that the special rate treatment afforded by the ICM is appropriate.

ICM CAPITAL PROJECTS– 2013 ($Millions)

Special Capital Projects

		2013 In $M
DL1	Timmins Downtown Underground Refurbishment Phase 1	**1.1**
DL4	Deep River Rehabilitation	**1.1**
DL12	Brockville TS M3 and M4 Underground Replacement	**5.7**
DL13	Martindale TS 9M5 Phase 3 of 6	**1.0**
DL14	Distribution System Modification	**2.0**
DL19	Brockville TS M2 Phase 3 of 6	**1.6**
DL21	Kam Reg DS Voltage Conversion Stage 2	**1.5**
DL22	Lauzon Belle River Reconfiguration	**1.1**
DL23	South Porcupine DS Conversion	**1.4**
DL29	Comber DS Removal	**0.9**
DL30	Edgeware TS M2 Relocation	**0.4**
DL31	Haileybury DS Voltage Conversion	**1.0**
F1	Fleet Replacement Project	
	- Chipper Replacement Program	**0.9**
	- GPS/Telematics Expansion	**7.2**
E1	Cornerstone Phase 3 - Enhanced Asset Management	**10.4**
E2	Final Destination Enterprise GIS Database Development	**10.9**
E3	Enterprise Application Replacement	**7.6**
Total Special Capital Projects		**55.8**

Escalated Issue Capital Programs/Projects

Capital Contribution – Commerce Way TS	**9.2**
Distribution and Regulating Stations*	**32.6**
Wood Pole Replacement	**22.9**
Total Escalated Issue Capital	**64.7**
Customer Information System Replacement	**155.4**
TOTAL ICM CAPITAL PROJECTS	**275.9**

* For the purposes of reaching a settlement this amount was lowered by $10M from the Applicant's original request. The revenue requirement associated with the ICM Capital is offset by $1.35M in OM&A to reflect the reduced OM&A costs that otherwise would have been associated with transformer refurbishments (9 transformers at $150,000 / transformer = $1.35 Million) which Hydro One advised would no longer be completed in light of the settlement achieved. Parties believe that this adjustment to OM&A is consistent with Filing Guideline EB-2007-0673 Supplemental Report of the Board dated September 17, 2008, Appendix B, page VI.

For the purpose of settlement, the parties agree that the need for the requested incremental capital projects has been demonstrated. Appendix A provides the total forecast revenue and the agreed upon ICM amounts. Further, it is agreed that when Hydro One returns to the Board for approval of its distribution rates in a cost of service proceeding, the guidance provided by EB-2007-0673 Supplemental Report of the Board will be followed:

> "At the time of rebasing, the Board will carry out a prudence review to determine the amounts to be incorporated in rate base. The Board will also make a determination at the time regarding the treatment of differences between forecast and actual capital spending during the IRM plan term. Overspending or underspending will be reviewed at the time of rebasing".

This review will relate to the projects identified above.

For the Board's ease of reference, the Applicant's original ICM projects are included in Exhibit B, Tab 1 Schedule 2 page 5, with further details on Typical Capital projects included in TCR VECC 5.

revenue determination, and the utility would be faced with an untenable choice between meeting its duties as a distributor and maintaining its financial viability.

Q22. Could the structural deficit you describe be eliminated or reduced by the Incremental Capital Module?

A22. No. While a limited number of discrete projects in THESL's capital plan might qualify for ICM treatment, they would be the exceptions. The majority of THESL's capital program is composed of routine, core-business requirements of a distributor: customer connection, infrastructure renewal, and other capital for customer services and distribution support. These expenditures are clearly not extraordinary, and the Board has clearly stated that the ICM was not intended for, and does not apply in, these circumstances.

Q23. Finally Mr. McLorg, given all that you have described in this Witness Statement, the evidence that has been pre-filed, and THESL's interrogatory responses, is it THESL's view that its particular circumstances could be addressed by THESL returning to the Board each year with an 'early rebasing' application?

A23. No, it is not. Repeated, successive early rebasing applications would defeat the purpose of the Board's IRM framework, create significant regulatory burden, and put THESL in a perpetual state of uncertainty with respect to its ongoing operations.

As stated in THESL's response to VECC IR #2, "It is not possible for THESL to conduct its business responsibly while planning for dramatically different business condition scenarios that would exist as alternatives for the same period." And as explained in THESL's response to Board Staff IR # 1, the differences between the COS framework and the IRM framework are real and material in terms of THESL' operational plans.

Furthermore, the circumstances in which THESL operates are not expected to change year over year, and the logic of ratemaking is not expected to change year over year. The

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further consultation on the appropriate stretch factor values for the three groups for 3rd Generation IR. The issue of the appropriate stretch factor values will therefore be included on the agenda for the August stakeholder conference (see Section 5).

2.5 Incremental Capital

In the consultation on 2nd Generation IR that occurred in 2006, a number of participants commented that the IR regime needs to ensure that sufficient incentives are available in order to achieve efficiencies, recognizing the time patterns of costs and savings; and to provide for the expeditious review and approval of capital expenditure programs. Some participants argued that certainty in relation to capital expenditures beyond the single future test year is needed. It was suggested that the regime could include some form of approval of a multi-year capital plan and not just capital items that may arise in the following year.

In its July 23, 2007 "Report of the Board on Rate-making Associated with Distributor Consolidation" and associated covering letter, the Board indicated that electricity distributors' concerns over partial rebasing to account for needed capital expenditures should be examined as part of the development of the 3rd Generation IR plan.

Issues and Options Raised in Consultation

Staff's Initial Proposals

The Discussion Paper noted that participants differed as to whether special treatment of capital spending is necessary in an IR framework; however, the Discussion Paper described an option that staff thought might be reasonable. The approach would allow for the intra-term approval by the Board and appropriate pass-through of incremental capital expenditures associated with growing capital program demands. Dr. Kaufmann advised in his May 6th presentation to participants that implicit in an X-factor is a historical pattern of capital expenditures for the industry, and that generally a separate capital module should not be required under a comprehensive rate indexing plan. However, he commented that if, going forward, projected capital investment is substantially different than the history of what is reflected in the X-factor, then there could be an issue and a capital module could be designed to address the disparity.

At the May 6, 2008 stakeholder meeting, staff proposed the introduction of an incremental capital module as a flexible and practical means of accommodating reasonable spikes in incremental capital investment needs during 3rd Generation IR. In brief, staff proposed that the module should only be invoked by a distributor intra-term and that any Board-approved amounts and rate base treatment should be fully resolved through comprehensive rebasing.

Under staff's proposal, in order to invoke the module a distributor would make specific application to the Board for review and approval. Staff proposed that the application would substantiate the need for incremental capital due to drivers that are non-discretionary in the control of the distributor's management such as: life-cycle replacement of aging distribution plant; and additions of non-revenue earning plant to meet new growth demands and/or address system impacts from customer choice of location for connection. Further, for incremental capital expenditures to be considered for recovery, staff proposed that the amounts would have to satisfy the eligibility criteria listed in Table 4.

Table 4: Staff's Proposed Incremental Capital Investment Eligibility Criteria

Criteria	Description
Causation	Amounts should be directly related to the claimed driver, which must be clearly non-discretionary. The amounts must be clearly outside of the base upon which rates were derived.
Materiality	The amounts must have a significant influence on the operation of the distributor; otherwise they should be dealt with at rebasing.
Prudence	The amounts to be incurred must be prudent. This means that the distributor's decision to incur the amounts must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.

Staff further proposed that applications should be accompanied by comprehensive evidence to support a claim for incremental capital and that subsequently there should be annual reporting requirements on actual amounts spent.

With regard to a materiality threshold, staff proposed a threshold of 25% of the capital budget reflected in base rates going in to IR and that the threshold must be met on an individual driver basis.

Staff's Revised Proposal

In response to participant comments, as summarized below, staff revised its proposal as described in the Board's May 15, 2008 letter to participants. To address comments from distributors, staff proposed a threshold of the distributor's average annual CAPEX since the Board-approved base year relative to 150% of the distributor's depreciation expense embedded in base rates. Staff believed that 150% would be appropriate in order to allow for the impact of inflation and to provide a cushion to ensure that only serious cases of incremental capital need are considered.

Staff also proposed changes in relation to the proposed scope for capital expenditures eligible for recovery through the module. Staff noted that, to date, revenue-earning plant had not been included in discussions. However, for reasons of simplicity, staff suggested that the threshold test be indifferent to the driver, and proposed instead that the need driving any amount applied for by a distributor should be dealt with in the distributor's application.

Finally, staff proposed that a distributor's application to the Board requesting rate relief for incremental CAPEX during IR include the following:

- An analysis demonstrating that the threshold test has been met and that the amounts will have a significant influence on the operation of the distributor;

- A description of the underlying causes and timing of the capital expenditures, including an indication of whether expenditure levels could trigger a further application before the end of the IR term;
- An analysis of the revenue requirement associated with the capital spending (i.e., the incremental depreciation, return on rate base and payments in lieu of taxes ("PILs") associated with the incremental capital), and a specific proposal as to the amount of rate relief sought;
- Justification that the impact on revenue required is incremental to what was included in the application for the base year. Amounts being sought should be directly related to the claimed cause, which must be clearly non-discretionary and clearly outside of the base upon which current rates were derived;
- Justification that the amounts to be incurred will be prudent. This means that the distributor's decision to incur the amounts represents the most cost-effective option (not necessarily least initial cost) for ratepayers;
- Evidence that the incremental revenue requested will not be recovered through other means (e.g., it is not being funded by the expansion of service to include new customers); and
- A description of the actions the distributor will take in the event that the Board does not approve the application.

General Comments

In general, distributors initially expressed a preference for a multi-year capital plan review and approval approach in addition to the availability of a capital investment module. Some distributors maintained that the issue of unfunded capital arises when a distributor has to undertake programs or projects to meet requirements that may be in excess of what is allowed in the price cap formula, which implicitly considers a steady state growth rate in depreciation and returns, based on the historical costs of capital, and capital expenditures that are in effect equal to that annual depreciation expense. While these distributors were supportive of moving forward with a comprehensive price cap for 3rd Generation IR and were not advocating that distributors be held "whole" during the term for all capital expenditures, some distributors did advocate that distributors have a reasonable expectation of achieving their approved returns without being unduly penalized by having to significantly reduce their OM&A and/or capital programs. While some distributors expressed concern about the magnitude of the threshold in staff's revised proposal, they commented that the form of the mechanism is a major step forward in recognizing the business drivers necessitating such a module.

Participants representing groups of ratepayers generally expressed concern that staff's proposed approach may over-compensate distributors and result in over-earning during the IR term without clear requisite benefits to ratepayers. Many of these participants commented that CAPEX will be addressed in rebasing prior to IR, and they cautioned that any approach implemented with a capital module should only deal with incremental needs and that applications should have to include comprehensive evidence to support the claim.

One participant recommended that module treatment of capital investment should only be extended to two categories of "need" (lumpy spending and spending to improve productivity) and only to the amount that is not captured through the basic "inflation minus productivity" indexing rate adjustment components.

Another participant commented that the IR plan term should be three years to help reduce potential need for some form of special treatment of materially significant investment. This participant acknowledged that, to the extent that distributors find during the term of the IR plan that the formula is not sufficient to support incremental capital expenditures, they should have an opportunity to apply for the Board for relief; however, the onus would be on the distributor to demonstrate why its rates, derived using the formula, would not be sufficient to support the incremental capital investment. Under a three-year plan, this participant noted, such requests would be the exception, and not the norm.

A third participant urged the Board not to include an incremental capital module, and noted that PEG clearly indicated that there is no need for any explicit adjustment for capital in the indexing mechanism just because rate base is growing. This participant suggested that, if a distributor believes that it has significant incremental capital needs, the distributor should be encouraged to make a cost of service or multiple year cost of service filing. This participant also recommended that, if distributors are allowed to invoke the incremental capital module, then the X-factor proposed by PEG should be increased significantly to reflect that a significant amount of the capital has been removed from a comprehensive incentive rate mechanism, leaving a partial mechanism. Finally, if incremental capital is approved in rates, this participant expressed the view that distributors cannot expect to retain any excess earnings that they may achieve over and above that level.

Comments on Scope

One participant representing a group of ratepayers commented that the Board should not allow incremental rates where, for example, a distributor seeks to capitalize more of the costs of its existing labour force, or where a distributor says that its input costs for poles have gone up faster than inflation, or where a distributor says that it wants to prepare for future growth patterns, because these are all capital spending issues that should be handled within, and not outside of, the price cap budget provided.

Comments on the Materiality Threshold

In response to staff's proposed 25% of capital budget threshold, distributors commented that linking an incremental capital module to a capital budget may be problematic because the base year capital budget is likely to vary significantly among distributors for a variety of reasons. They also commented that capital budgets could be distorted and/or not representative of future investment trends depending on investment cycles, the lumpiness of certain types of investments, and similar factors. Two participants commented that with the 25% of capital budget threshold the module could also be triggered even if rate base is declining (i.e., capital expenditures are less than depreciation expense).

Commenting that the proposed application requirements appear acceptable and not excessive, one distributor commented that the 150% depreciation threshold is appropriate and will address the most serious cases. However, some distributors, agreeing in general with the application requirements, commented that 150% depreciation is too high, and proposed the use of 125% above the depreciation expense from the approved base year. Another participant commented that the threshold of 150% may underestimate the degree of hardship for some, and encouraged the Board to allow applications for incremental CAPEX that will have significant influence on operations, regardless of the amounts.

One participant representing a group of ratepayers commented that the 150% of depreciation threshold is an improvement over the 25% of capital budget threshold. However, this participant expressed concern that, depending on what amount would actually be recovered through the module and subsequently what level of depreciation expense becomes the new benchmark for the threshold test, distributors may be encouraged to over spend on capital expenditures or accelerate their capital spending if they are near the threshold in order to use the module to increase revenue. This participant proposed that, if at the end of the IR term the actual CAPEX to depreciation ratio falls below 150%, any revenues collected through the application of the incremental capital module should be rebated to customers (with appropriate interest).

Another participant representing a different group of ratepayers commented that the use of an average is an improvement over staff's original proposal, but cautioned that it can still lead to perverse results with regard to the timing of expenditures (i.e., re-adjusting forecasted capital needs to be eligible for the module sooner). This participant recommended that application requirements include sufficient information to test this issue.

Commenting that the proposed 150% depreciation is too low, a fourth participant representing another group of ratepayers demonstrated the relationship between annual capital spending (affected by inflation) and the base depreciation levels already built into rate base. For example, this participant commented, for a distributor with zero growth (and therefore constant real dollar capital spending), at a 2% inflation rate (i.e., the Bank of Canada target inflation rate) and a 3.9% average depreciation rate (the current Ontario norm), the price cap mechanism naturally provides for capital spending of 150% of depreciation or more; and where a distributor has growth, it will have available, without any special treatment, substantially more than the 150% level. This participant expressed the belief that the threshold has to be at least 20% higher than the CAPEX spending provided for naturally by the price cap regime. Further, this participant stated that it is possible to estimate the amount of CAPEX generally allowed for by the price cap, tracked to growth rates, and thus to create a simple threshold formula that depends only on the approved depreciation level, and the distributor's growth rate.

Comments on Implementation Issues

While participants generally expressed a relatively common understanding of the overall intent of the capital module and how it might be implemented, they differed on views with regard to details.

Some distributors proposed specific considerations for implementation of a capital module that were generally consistent with staff's revised proposal, with the exception of a lower materiality threshold (125% depreciation included in base rates). Also, these distributors suggested that while they agreed that annual reporting on actual spend would be appropriate, no true-up would be required for the IR term unless there was evidence that there was a serious overstatement of capital requirements. In contrast, a participant representing a group of ratepayers noted that the application of the module would be based on forecast capital expenditures from the distributors and therefore a true-up should be used to reflect differences between the actual and forecast amounts, particularly if the actual expenditures, for whatever reason, do not hit the 150%

materiality threshold that they were forecast to hit. Two other participants commented that if an application addresses more than one year (looking forward) then forecasting accuracy (in terms of both capital spending and customer load) as well as the potential for variances between forecast and actual spending amounts become more significant matters and there is an increased need for ratepayer protection.

To mitigate the potential for unintended results with regard to the timing of expenditures, another participant recommended that, in addition to what was already identified in staff's revised proposal, the application requirements should also include a requirement that the distributor do the following: demonstrate that the incremental revenue requirement impact is not covered by the IR mechanism through the provision of forecasts for customer count, volumes and associated revenue, and revenue requirement associated with existing and proposed capital; and calculate the "rate adder" associated with the incremental revenue requirement. Another participant expressed support for a deferral account approach, consistent with the current mechanism in place to deal with smart meter expenditures, with amounts subject to a true-up upon rebasing based on the actual amounts spent. This participant noted that this could be captured through a rate rider rather than an adjustment to rates.

Policy and Rationale

The Board has determined that there will be an incremental capital module in 3rd Generation IR. Distributors with an amount of capital spending that exceeds the materiality threshold may best be accommodated through rebasing. However, on balance, as all participants acknowledged, some incremental capital investment needs may arise during the IR term and the Board notes that a clearly defined modular approach is generally accepted.

The incremental capital module described in this report is intended to address concerns over the treatment of incremental capital investment needs that may arise during the IR term.

While the module may provide for a broad scope for incremental capital needs, specific application must be made to provide for review and approval of stated need. Applications must be accompanied by comprehensive evidence to support the claimed need. The Board considers that the application requirements proposed by staff are reasonable.

For incremental capital expenditures to be considered for recovery prior to rebasing, amounts must satisfy the eligibility criteria set out in Table 5.

Table 5: Incremental Capital Investment Eligibility Criteria

Criteria	Description
Materiality	The amounts must exceed the Board-defined materiality threshold and clearly have a significant influence on the operation of the distributor; otherwise they should be dealt with at rebasing.
Need	Amounts should be directly related to the claimed driver, which must be clearly non-discretionary. The amounts must be clearly outside of the base upon which rates were derived.
Prudence	The amounts to be incurred must be prudent. This means that the distributor's decision to incur the amounts must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.

As noted in the above table, **eligibility of a distributor to apply for rate relief through the module will be subject to a materiality threshold**. **However, the Board would be assisted by further consultation on the appropriate materiality threshold. The issue of the appropriate materiality threshold will therefore be included on the agenda for the August stakeholder conference (see Section 5).**

The Board has also determined that there will be annual reporting on actual capital spending and a prudence review at the time of rebasing. Distributors that receive rate relief through this module will be required to report to the Board annually on the actual amounts spent. At the time of rebasing, the Board will carry out a prudence review to determine the amounts to be incorporated in rate base. The Board will also make a determination at that time regarding the treatment of differences between forecast and the actual spending during the IR plan term. If the forecast costs

exceeded actual amounts spent, the difference will be returned to ratepayers. Cost overruns will be reviewed at the time of rebasing.
The Board agrees with the comments of all participants that capital expenditures mandated through government policy (e.g., smart meters) should continue to be dealt with outside of the IR plan.

With the exception of the value of the materiality threshold, the Appendix outlines the detailed requirements as they apply to 3rd Generation IR.

2.6 Treatment of Unforeseen Events

Z-factors are intended to provide for unforeseen events outside of management's control, and are a common feature of IR plans. In general, the cost to a distributor of these events must be material and its cost causation clear.

Issues and Options Raised in Consultation

The Discussion Paper acknowledged a number of issues related to Z-factor claims by electricity distributors, including the general view of distributors and other stakeholders that the current materiality thresholds are too low. The Discussion Paper identified the option of raising the two existing materiality thresholds for expenses and capital costs from the current 0.2 percent to 3 percent. During the May 6, 2008 stakeholder meeting, and in response to participant comments as summarized below, staff proposed the continuation of the current rules, with the exception of the scope of events that would qualify for Z-factor treatment and of the materiality threshold, and put forward a single threshold of 0.5 percent on total revenue requirement.

For 2nd Generation IR, Z-factors are limited to natural disasters and tax changes. One distributor questioned whether Z-factors need to be this limited. This distributor expressed the view that the eligibility criteria and the application filing, review and approval process requirements are adequate to discourage applications for relatively

Appendix: Filing Guidelines

These filing guidelines set out the Board's expectations for applications by distributors for rate adjustments on the basis of the 3rd Generation IR mechanism as set out in this report.

General

The implementation of the 3rd Generation IR mechanism will occur first with rate adjustments scheduled for May 1, 2009.

The price cap adjustment will be applied to the Service Charge and Distribution Volumetric Rate (including low voltage charges for embedded distributors), net of existing rate adders and rate rebalancing adjustments as determined necessary by the Board. The price cap adjustment will not be applied to Rate Riders, Retail Transmission Service Rates, Wholesale Market Service Rate, Rural Rate Protection Charge, Standard Supply Service – Administrative Charge, Specific Service Charges, Allowances[5], Retail Service Charges or Loss Factors.

The price cap adjustment will reflect inflation less the X-factor, and an adjustment for the transition to the common deemed capital structure of 60% debt and 40% equity.

[5] Transformation and primary metering allowances and any other allowances the Board may determine.

Manager's Summary

Each application should include a completed Model and a brief Manager's Summary explaining all rate adjustments applied for. Any deviations should be thoroughly documented. Where necessary, support for applied adjustments, such as continuation of rate riders or for Z-factors, should be provided.

Incremental Capital Module

The incremental capital module has been incorporated into the 3rd Generation IR mechanism to address the treatment of incremental capital investment needs that arise during the IR plan term.

Eligibility Criteria for Incremental Capital Module Applications

The eligibility criteria for applications to recover amounts through rates to fund incremental capital investment needs are discussed in section 2.5 of this report, and are reproduced in Table 7 below for convenience:

Table 7: Incremental Capital Investment Eligibility Criteria

Criteria	Description
Materiality	The amounts must exceed the Board-defined materiality threshold and clearly have a significant influence on the operation of the distributor; otherwise they should be dealt with at rebasing.
Need	Amounts should be directly related to the claimed driver, which must be clearly non-discretionary. The amounts must be clearly outside of the base upon which rates were derived.
Prudence	The amounts to be incurred must be prudent. This means that the distributor's decision to incur the amounts must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.

Materiality Threshold

To be determined by the Board.

Filing Guidelines

The Board expects that applications requesting relief for incremental CAPEX during the IR plan term will be accompanied by comprehensive evidence to support the claimed need, and include the following:

- An analysis demonstrating that the materiality threshold test has been met and that the amounts will have a significant influence on the operation of the distributor;
- A description of the underlying causes and timing of the capital expenditures including an indication of whether expenditure levels could trigger a further application before the end of the IR term;
- An analysis of the revenue requirement associated with the capital spending (i.e., the incremental depreciation, OM&A, return on rate base and PILs associated with the incremental capital), and a specific proposal as to the amount of relief sought;
- Justification that amounts being sought are directly related to the claimed cause, which must be clearly non-discretionary and clearly outside of the base upon which current rates were been derived;
- Justification that the amounts to be incurred will be prudent. This means that the distributor's decision to incur the amounts represents the most cost-effective option (not necessarily least initial cost) for ratepayers;
- Evidence that the incremental revenue requested will not be recovered through other means (e.g., it is not, in full or in part, included in base rates or being funded by the expansion of service to include new customers); and
- A description of the actions the distributor will take in the event that the Board does not approve the application.

Reporting Requirements

Distributors that receive rate relief through this module will be required to report to the Board annually on the actual amounts spent. At the time of rebasing, the Board will carry out a prudence review to determine the amounts to be incorporated in rate base. The Board will also make a determination at that time regarding the treatment of differences between forecast and actual capital spending during the IR plan term. If the forecast costs exceeded actual amounts spent, the difference should be returned to ratepayers. Cost overruns will be reviewed at the time of rebasing.

Z-Factors

Z-factors are events that are not within management's control. A distributor will be expected to supply the details of management's plans for addressing these events in support of the distributor's request for special cost recovery.

A distributor may record amounts which meet the eligibility criteria presented below for Z-factor events.

A distributor is expected to follow the guidelines listed below when applying to the Board to recover from ratepayers the amounts that the distributor has recorded. The Board may limit the recovery of certain amounts.

Eligibility Criteria for Z-factor Amounts

The eligibility criteria for applications to recover amounts in the Z-factor are discussed in section 2.6 of this report, and are summarized inTable 8 below. In order for amounts to be considered for recovery in the Z-factor, the amounts must satisfy all three criteria set out in Table 8.

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Board staff provided analysis based on RRR data that suggested that with a threshold equal to 150 percent, there would be more than 20 distributors eligible to apply and with a threshold equal to 200 percent, there would be about 10 distributors eligible. VECC observed that reviewing a capital module application may not be a simple process. It may require the review of productivity improvements inherent in capital spending and the setting of load forecasts. Therefore, VECC recommended that the Board keep this in mind when determining the threshold value. CCC observed that if in the first year the Board receives a large volume of capital module applications, then perhaps the threshold should be reconsidered.

In response to staff's 50 percent estimate for inflating depreciation expense to replacement dollars, Hydro One and the CLD estimated that adding this into the materiality threshold could translate into a decrease in ROE on an annual basis of up to 100 basis points for some distributors. Further, this impact could be cumulative over the three-year IR plan term. Therefore, Hydro One and the CLD did not support including the inflation adder to the materiality threshold, citing concerns that it would be the distributor that would have to fund this 50 percent factor that relates to capital spending. Hydro One and the CLD also observed that distributors need to reliably operate and sustain the businesses that they are licensed to conduct and submitted that if the capital module threshold, the productivity factor and the stretch factors are set too high then they may be compelled to make cost-of-service applications.

Board Policy and Rationale

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

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

A review of an application will test whether the applicant has passed the materiality threshold, and, if it does, will scrutinize the need for the requested incremental capital relief. Such scrutiny will entail reviewing the distributor's assumptions and planning and examining alternative options, and its overall CAPEX plan. If the application succeeds, in whole or in part, the Board will adjust rates to reflect a higher CAPEX as appropriate. It is important to note that the adjustment in rates will be linked solely to the costs of the incremental capital. Therefore, distributors should not perceive this activity as an opportunity to true up rate base for any other reason.

The incremental capital for which the Board may provide rate relief is the new capital sought in excess of the materiality threshold. The proceeding to consider an eligible distributor's application for rate relief would examine the reasonableness of the distributor's increased spending plan. If the application is approved, a rate rider would be established to reflect an amount sufficient to accommodate the portion of the approved incremental spending that exceeds the threshold amount. In calculating the rate relief, the Board has determined not to apply the half-year rule so as not to build in a deficiency for subsequent years in the term of the plan.

Distributors that receive rate relief through this module will be required to report to the Board annually on the actual amounts spent. At the time of rebasing, the Board will carry out a prudence review to determine the amounts to be incorporated in rate base. The Board will also make a determination at that time regarding the treatment of differences between forecast and actual capital spending during the IR plan term. Overspending or underspending will be reviewed at the time of rebasing.

With respect to the threshold itself, the Board believes that distributors should be able to determine whether or not they are eligible to apply with relative ease. Making that determination should not be an unduly cumbersome exercise. It should be formulaic and it should be relatively easy to populate with the required data.

With rebasing at the end of 2nd Generation IR, and before commencing 3rd Generation IR, a distributor's rates include a CAPEX component. The adequacy of such CAPEX provision in rates during 3rd Generation IR depends on whether or not the need for CAPEX during 3rd Generation IR can be met through existing rates, as adjusted under the 3rd Generation IR regime and considering organic growth. There is no dispute among participants that the price adjustment and organic growth factors should be captured in the calculation of the threshold and that not doing so would amount to "double-dipping".

A constant theme in this and earlier consultations has been the notion that there is diversity among distributors in their needs for future CAPEX. The Board sees merit in an incremental capital module that considers the diversity among the distributors, as long as it can be implemented in a manner that is not unduly cumbersome. The Board has not observed any objections to this approach.

There was considerable support for the formula presented by Mr. Aiken on behalf of LPMA and Energy Probe. That formula incorporates both the impact of the price cap and of load growth on the level of CAPEX that can be funded without additional rate relief and does this on a distributor-specific basis, reflecting both distributor diversity and the differing positions of the distributors in the asset replacement cycle. The data

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Chapter 3 of the Filing Requirements For Electricity Transmission and Distribution Applications

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The price cap index adjustment is determined as the annual percentage change in the GDP-IPI less the X-Factor. The X-factor is 0.72% plus a stretch factor. The value of the stretch factor is specific to each distributor for each rate year, and will be one of the following values: 0.2%; 0.4%; or 0.6%. The Board will determine each distributor's stretch factor. The distributor specific stretch factors will not be available before the application is filed. Therefore, the Rate Generator will include a proxy stretch factor of 0.4%. Once the distributor specific stretch factors become available, Board staff will adjust the stretch factor in each distributor's individual Rate Generator. Distributors will have an opportunity to comment on the accuracy of Board staff's update as part of the draft Rate Order process.

The price cap index adjustment will not be applied to the following components of delivery rates:

- Rate Adders;
- Rate Riders;
- Low Voltage Service Charges;
- Retail Transmission Service Rates;
- Wholesale Market Service Rate;
- Rural Rate Protection Charge;
- Standard Supply Service – Administrative Charge;
- MicroFIT Service Charge;
- Specific Service Charges; and
- Transformation and Primary Metering Allowances.[4]

2.2 Incremental Capital Module

The incremental capital module ("ICM") is intended to address the treatment of new capital investment needs that arise during the IRM plan term which are incremental to the materiality threshold defined below.

The eligibility criteria to recover amounts that are incremental to capital investment needs are included in section 2.5 of the *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, dated* July 14, 2008 and are reproduced below.

4 and any other allowances the Board may determine.

Criteria	Description
Materiality	The amounts must exceed the Board-defined materiality threshold and clearly have a significant influence on the operation of the distributor; otherwise they should be dealt with at rebasing.
Need	Amounts should be directly related to the claimed driver, which must be clearly non-discretionary. The amounts must be clearly outside of the base upon which rates were derived.
Prudence	The amounts to be incurred must be prudent. This means that the distributor's decision to incur the amounts must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.

2.2.1 ICM Materiality Threshold

The ICM materiality threshold is discussed in section 2.3 of the *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* (the "Supplemental Report") EB-2007-0673.

The Board has determined that the following formula is to be used by a distributor to calculate the materiality threshold that will apply to it:

$$Threshold\ Value = 1 + \left(\frac{RB}{d}\right) * (g + PCI * (1 + g)) + 20\%$$

Where:

RB = rate base included in base rates ($);

d = depreciation expense included in base rates ($);

g = distribution revenue change from load growth (%); and

PCI = price cap index (% inflation less productivity factor less stretch factor).

The values for "RB" and "d" are the Board-approved amounts in the distributor's base year rate decision.

The value for "g" is the % difference in distribution revenues between the most current complete year and the base year.

The following table provides an example of the calculation of the materiality threshold values.

An Illustration:			
Assumptions:	RB	=	\$100 million;
	d	=	\$5 million;
	g	=	1.5% (0.015); and
	PCI	=	0.75% (0.0075).
Calculation:	$1+(\frac{100,000,000}{5,000,000})*(0.015+.0075*(1+0.015))+0.20=1.65$		
Result:	The materiality threshold (CAPEX/Depreciation) is 1.65 or 165%. That is, given the assumptions in this example, the Board expects the distributor to manage a CAPEX level of up to \$8.26 million (\$5 million * 1.65) before being eligible to apply to recover incremental amounts.		

2.2.2 Eligible Incremental Capital Amount

In the Supplemental Report, the Board determined that eligible incremental capital amount sought for recovery should be new capital in excess of the materiality threshold. The materiality threshold value, as calculated using the formula discussed in Section 2.2.1, establishes eligibility for incremental capital spending and also marks the base from which to calculate the maximum amount eligible for recovery. A distributor applying for recovery of incremental capital should calculate the maximum allowable capital amount by taking the difference between the 2013 total non-discretionary capital expenditure and the materiality threshold.

2.2.3 Application of the Half-Year Rule

The Board's general guidance on the application of the half-year rule is provided in the Supplemental Report. In this report the Board determined that the half-year rule should not apply so as not build a deficiency for the subsequent years of the IRM plan term. In a subsequent decision with respect to the application of the half-year rule in the context of an ICM, the Board decided that the half-year rule would apply in the final year of the IRM plan term[5]. The Board has adopted this as a clarification to the policy on ICM.

2.2.4 Revenue Requirement Calculation

When calculating the revenue requirement associated with the ICM, a distributor should use the following parameters:

- Cost of Capital
  - In the *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors*, issued

[5] EB-2010-0130, Guelph Hydro Electric Systems Inc., *Decision and Order,* p. 15

December 20, 2006 ("2006 Report") the Board outlined the transition to a single deemed capital structure of 60% debt and 40% equity. Since all distributors have completed the transition to a 60/40 debt-equity ratio, a distributor filing for an ICM adjustment shall use this deemed capital structure.

  - On December 11, 2009 the Board issued the *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* (the "2009 Report"). The 2009 Report sets out revised cost of capital parameters to be effected in cost of service applications. A distributor filing an ICM adjustment, shall use the last Board-approved cost of capital parameters determined during the distributor's last rebasing application when calculating the revenue requirement associated with the ICM.

- PILS
  - Since currently known legislated tax changes from the level reflected in the Board-approved base rates for a distributor will be reflected in the IRM adjustments, a distributor filing for an ICM adjustment should apply the current tax rates when calculating the revenue requirement associated with the ICM.

- Working Capital Allowance ("WCA")
  - A distributor filing an ICM adjustment shall use the last Board-approved WCA determined during the distributor's last rebasing application when calculating the revenue requirement associated with the ICM.

2.2.5 ICM Filing Guidelines

The Board requires that a distributor requesting relief for incremental capital during the IRM3 plan term must include comprehensive evidence to support the claimed need, which should include the following:

- An analysis demonstrating that the materiality threshold test has been met and that the amounts will have a significant influence on the operation of the distributor;
- Justification that the amounts to be incurred will be prudent. This means that the distributor's decision to incur the amounts represents the most cost-effective option (not necessarily least initial cost) for ratepayers;
- Justification that amounts being sought are directly related to the claimed cause, which must be clearly non-discretionary and clearly outside of the base upon which current rates were derived.

- Evidence that the incremental revenue requested will not be recovered through other means (e.g., it is not, in full or in part, included in base rates or being funded by the expansion of service to include new customers and other load growth);
- Details by project for the proposed capital spending plan for the test year segregated between discretionary and non-discretionary;
- A description of the proposed non-discretionary capital projects and expected in-service dates;
- Calculation of the revenue requirement associated with each proposed incremental non-discretionary capital project (i.e. the cost of capital, depreciation, and PILs);
- Calculation of revenue requirement offsets associated with each incremental non-discretionary projects due to revenue to be generated through other means (e.g. customer contributions in aid of construction);
- A description of the actions the distributor will take in the event that the Board does not approve the application.
- Calculation of a rate rider to recover the incremental revenue from each class and the rationale for the proposed approach.

2.2.6 ICM Reporting Requirements

A distributor that receives rate relief through this module will be required to report to the Board annually on the actual amounts spent. At the time of the next rebasing, the distributor will file a calculation of the amounts to be incorporated in rate base. At that time the Board will make a determination on the treatment of any difference between forecast and actual capital spending during the IRM plan term. Any overspending or underspending will be reviewed at the time of rebasing.

2.2.7 ICM Accounting Treatment

The distributor will record eligible ICM amounts in Account 1508, Other Regulatory Asset, sub-account Incremental Capital Expenditures, subject to the assets being used and useful. For incremental capital assets under construction, the normal accounting treatment will continue in the construction work in progress ("CWIP") prior to these assets going into service and hence eligible for recording in the 1508 sub-account. The amortization of capital assets for the relevant accounting period will be recorded in a separate amortization account of the sub-account, Incremental Capital Expenditures. In addition, the revenues collected from the rate rider will be recorded in Account 1508, Other Regulatory Asset, sub-account, Incremental Capital Expenditures rate rider.

The distributor shall also record monthly carrying charges in sub-accounts Incremental Capital Expenditures and Incremental Capital Expenditures rate rider. Carrying charges amounts are calculated using simple interest applied to the monthly opening balances in the account and recorded in a separate sub-account of account 1508. The rate of interest shall be the rate prescribed by the Board for deferral and variance accounts for the respective quarterly period published in the Board's web site.

2.2.8 Rate Generator and Supplemental Filing Module for ICM

The supplemental filing module supporting the Rate Generator will assist the distributor in calculating the distributor's threshold. The distributor will then tabulate the value of its eligible non-discretionary investments and compare this to the threshold. Other calculation work forms will be provided to calculate the revenue requirement for each project proposed for inclusion in the ICM request in the supplemental filing module. Once all work forms are completed and listed in the supplemental module, the tabulated revenue requirement will be converted into a rate rider.

2.3 Z-factor Claims

Z-factors are intended to provide for unforeseen events outside of a distributor's management control. The cost to a distributor must be material and its causation clear. A distributor must follow the guidelines listed below when applying to the Board to recover the amounts that the distributor has recorded in a Board-approved deferral account related to a Z-factor claim.

2.3.1 Eligibility Criteria for Z-factor Amounts

The eligibility criteria for a request to recover amounts by way of a Z-factor are discussed in section 2.6 of the *Board's Report on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* – July 14, 2008, and are summarized in Table 1 below. In order for amounts to be considered for recovery by way of a Z-factor, the amounts must satisfy all three eligibility criteria set out in Table 1 below.

Table 1: Z-factor Amount Eligibility Criteria

Criteria	Description
Causation	Amounts should be directly related to the Z-factor event. The amount must be clearly outside of the base upon which rates were derived.
Materiality	The amounts must exceed the Board-defined materiality threshold and have a significant influence on the operation of the distributor; otherwise they should be expensed in the normal course and addressed through organizational productivity improvements.
Prudence	The amount must have been prudently incurred. This means that the distributor's decision to incur the amount must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.