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December 21, 2012

via RESS e-filing – signed original to follow by courier

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

Dear Ms. Walli:

Re: Toronto Hydro-Electric System Limited ("THESL")
OEB File No. EB-2012-0064 (the "Application")
THESL's Argument in Chief

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

Please find attached THESL's Argument in Chief pursuant to the schedule established by the OEB at the Oral Hearing (December 13, 2012).

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

Yours truly,

[original signed by]

Amanda Klein
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:AK/km

cc: Fred Cass of Aird & Berlis LLP, Counsel for THESL, by electronic mail only
Intervenors of Record for EB-2012-0064 by electronic mail only

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

AND IN THE MATTER OF an application by Toronto Hydro-Electric System Limited for an order approving just and reasonable rates and other charges for electricity distribution to be effective June 1, 2012, May 1, 2013 and May 1, 2014.

ARGUMENT IN CHIEF OF
TORONTO HYDRO-ELECTRIC SYSTEM LIMITED

1. Introduction

1. On May 10, 2012, Toronto Hydro-Electric System Limited (Toronto Hydro or THESL) filed an application seeking approval for changes to rates charged for electricity distribution to be effective June 1, 2012, May 1, 2013 and May 1, 2014. The application was filed under the Board's Incentive Regulation Mechanism (IRM) framework and it included a request for approval made in accordance with the Board's Incremental Capital Module (ICM).

2. The specific relief requested by Toronto Hydro is set out in detail in the Manager's Summary.[1] In the Manager's Summary, Toronto Hydro also put forward for the Board's consideration a modification to the standard ICM model that has a rate mitigation effect if the approved ICM amounts for 2012 and 2013 exceed a certain level. The rate mitigation alternative, in essence, would involve the Board dispensing with the 20% threshold under the ICM model and using the half-year rule for all years of approved ICM spending.[2]

3. The Board rendered its decision with respect to the Issues List for this proceeding on August 16, 2012.[3] The Board-approved Issues List sets out issues in four main categories, as follows:

(a) IRM Schedules and Models;
(b) ICM;
(c) Deferral and Variance Accounts; and
(d) Implementation.[4]

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[1] Pre-filed Evidence, Tab 2, as updated and corrected.
[2] Manager's Summary, Pre-filed Evidence, Tab 2, page 12.
[3] Issues List Decision, August 16, 2012.
[4] Issues List Decision, Appendix A.

4. On October 31, 2012, Toronto Hydro filed updated evidence to take into account the reality that a Board decision in respect of capital spending for 2012 would not be available until late 2012 or early 2013. Following the filing of this updated evidence, the Board accepted a proposal by Toronto Hydro that, with the exception of the Bremner Station project, the Board's consideration of capital spending for 2014 be deferred until a later phase of this proceeding.[5]

5. Procedural Order No. 3 issued by the Board on November 8, 2012 made provision for a number of procedural steps, including an oral hearing of evidence commencing on December 10, 2012.[6] The oral hearing of evidence before the Board commenced as scheduled on December 10, 2012 and concluded on December 14, 2012.

6. At the oral hearing, the focus of examination by intervenors and Board staff was Toronto Hydro's ICM proposal for 2012 and 2013, or, in other words, the second main category of issues set out in the Issues List. There were few, if any, issues raised with respect to the other three main categories in the Issues List, which, as indicated in paragraph 3, above, are IRM Schedules and Models, Deferral and Variance Accounts and Implementation. Accordingly, in this Argument in Chief, Toronto Hydro will focus its submissions on the ICM proposal.

2. Proposed ICM Spending in 2012 and 2013

7. In its EB-2011-0144 Decision issued on January 5th of this year, the Board provided guidance with regard to Toronto Hydro's capital expenditures[7] and the Board's ICM model.[8] More particularly, the Board made the following specific comments about an ICM application by Toronto Hydro:

> It remains open to THESL to file an IRM application for 2012, including an ICM application. The Board encourages THESL to do so.[9]

8. Toronto Hydro proceeded in accordance with the Board's comments and it formulated an ICM application to meet the Board's directions. In doing so, Toronto Hydro developed a capital spending proposal that is based on a careful application of the ICM model[10] and that is sharply focused on non-discretionary work.[11]

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[5] Procedural Order No. 3, November 8, 2012, page 3.
[6] Procedural Order No. 3, page 7.
[7] Decision with Reasons and Order on the Preliminary Issue, January 5, 2012 (EB-2011-0144 Decision), pages 18 to 21.
[8] EB-2011-0144 Decision, pages 21 to 23.
[9] EB-2011-0144 Decision, page 15.
[10] See Manager's Summary, Pre-filed Evidence, Tab 2, page 14.
[11] See Manager's Summary, Pre-filed Evidence, Tab 2, pages 16-17.

9. Toronto Hydro filed highly detailed and thorough evidence to support its case that the proposed capital work is both essential and prudent. This detailed and thorough evidence includes business cases for each of the different areas of work in the ICM application.[12] The evidence also includes a review of the business cases by experts from Navigant Consulting Ltd. and Power System Engineering, Inc.[13]

10. Before filing its update, Toronto Hydro took another hard look at its capital program and removed the grid solutions work.[14] As a result, the evidence filed in this case is quite unlike the capital budget evidence that would typically be filed in a cost of service rate case or the evidence that has been filed in any IRM case. Toronto Hydro's proposed capital spending has been through a very careful screening analysis to ensure that it is essential, non-discretionary and prudent and it has been supported by an evidentiary base that may well be unprecedented for the level of detail that has been provided to the Board.

11. Further, the witnesses who testified in support of the evidence are employees of Toronto Hydro who are very knowledgeable about Toronto Hydro's operational requirements and who were able to explain from an operational point of view the need for the proposed capital spending. During the hearing, these witnesses were cross-examined at great length. Toronto Hydro submits, with respect, that the lengthy cross-examination of these witnesses raised no meaningful doubts about the non-discretionary nature of the proposed work. The evidence of the witnesses revealed a thorough understanding of the proposed work, to the level of even the most elementary details, and an unwavering conviction that all of the work is prudent and based on non-discretionary drivers.

12. Much of the cross-examination of the witnesses, Toronto Hydro submits, did not go to the non-discretionary nature of the work at all. Rather, during cross-examination, there were many suggestions put to the witnesses about how Toronto Hydro might perhaps go about its work differently. There are two important points that must be made about these suggestions that Toronto Hydro could perhaps go about its work in a different manner.

13. First, while Toronto Hydro certainly respects the views of others who put forward suggestions about the work, it is submitted that those who know the work best are the employees of Toronto Hydro whose job it is to understand and address Toronto Hydro's operational requirements on a day-to-day basis. Second, to the extent that the Board considers it appropriate to entertain suggestions about how Toronto Hydro should go about its work, it is submitted that there should be actual evidence from experts in this area, rather than assertions put forward in cross-examination that are not supported by actual evidence.

[12] Pre-filed Evidence, Tab 4, Schedules B1 to B21.
[13] Pre-filed Evidence, Tab 4, Schedules D4 and D5.
[14] The grid solutions work was originally filed at Tab 2, Schedule B22.

14. In short, after extensive cross-examination at the hearing, it remains clear that Toronto Hydro has proposed ICM spending that is essential, non-discretionary and prudent. In particular, it came out clearly during the hearing that Toronto Hydro's proposed ICM spending is aimed primarily at maintaining the safety and reliability of the system and is needed to meet customers' expectations of safety and reliability. Given this need to maintain the safety and reliability of the system, Toronto Hydro submits that the central question in this case is how to ensure that this essential capital spending is properly funded. Put differently, the evidence presented by Toronto Hydro leaves no room for doubt that the work it has proposed needs to be done; what this case is really about is how the ICM model is to be applied to see that the work gets done.

15. Toronto Hydro submits that it is important that all participants in this proceeding have regard to the need for funding to maintain the safety and reliability of a vital electricity distribution system in the Province. Toronto Hydro also submits that a regulatory mechanism or framework, such as the ICM, should not be applied in a manner that causes the mechanism to become an obstacle to the funding of an important and necessary capital program such as that of Toronto Hydro.

16. Indeed, Toronto Hydro submits that the ICM is not meant to be an obstacle to the appropriate funding of essential capital work during the term of an IRM plan. As stated by Mr. McLorg:

> …Toronto Hydro has come through this process to see the ICM as a vehicle through which essential capital spending that goes to the utility's core requirements as a distributor, and which is not otherwise funded, can be accommodated.[15]

<u>3. Toronto Hydro's ICM Application</u>

17. As referred to above, the Board encouraged Toronto Hydro, in the EB-2012-0144 Decision, to file an ICM application for 2012. The same decision went on to make a number of observations about the ICM, as it would apply to the situation of Toronto Hydro. The Board said, in the EB-2012-0144 Decision, that:

> The ICM was developed to address the circumstances of increased capital needs within 3GIRM.[16]

18. The subsequent paragraphs of the EB-2012-0144 Decision include a review of a number of the Board's previous ICM decisions, leading to the following comment:

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[15] 5Tr.69
[16] EB-2012-0144 Decision, page 21.

> The Board's thinking in this area has evolved, and in the recent ICM decisions the Board has granted relief for discrete, material and non-discretionary projects which cannot be funded through the normal operation of the 3GIRM mechanism.[17]

19. The evolution of the Board's thinking with respect to the ICM was confirmed when the Board released revised Filing Requirements for Electricity Transmission and Distribution Applications on June 28, 2012 (the Revised Filing Requirements).[18] As will be addressed below, Toronto Hydro's ICM application certainly complies with the ICM provisions of the Revised Filing Requirements. The fact is, though, that the filing of Toronto Hydro's ICM application pre-dated the release of the Revised Filing Requirements.

20. When it prepared the ICM application, Toronto Hydro took guidance from a number of sources including the Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors dated July 14, 2008 (the 3GIRM Report),[19] the Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors (the Supplemental Report)[20] and the cases in which the Board has considered ICM applications.

21. It was and is clear to Toronto Hydro from these sources that the Board's ICM framework is based on a "capital spending" model. There are many references in these sources to a model that is based on capital expenditures (CAPEX) or a capital spending plan and Toronto Hydro will not attempt to list exhaustively all such references. The following are some examples from the Supplemental Report which make clear that the ICM framework is based on a spending model:

> (a) "Such scrutiny will entail reviewing the distributor's … overall CAPEX plan."[21]
>
> (b) "If the application succeeds … the Board will adjust rates to reflect a higher CAPEX as appropriate."[22]
>
> (c) "The proceeding … would examine the reasonableness of the distributor's increased spending plan."[23]

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[17] EB-2012-0144 Decision, page 22.
[18] Ontario Energy Board Filing Requirements for Electricity Transmission and Distribution Applications, Last Revised on June 28, 2012, Chapter 3.
[19] Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, July 14, 2008.
[20] EB-2007-0673 Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, September 17, 2008.
[21] Supplemental Report, page 31.
[22] *Ibid.*
[23] *Ibid.*

(d) "…a rate rider would be established to reflect … approved incremental spending that exceeds the threshold amount."[24]

(e) "Distributors … will be required to report to the Board annually on the actual amounts spent."[25]

(f) "The Board will also make a determination [at the time of rebasing] regarding … differences between forecast and actual capital spending … ."[26]

(g) "A constant theme … has been … diversity among distributors in their needs for future CAPEX."[27]

(h) "…formula incorporates … impact … on the level of CAPEX that can be funded without additional rate relief … ."[28]

22. These references to "capital spending" are reflected in the Board's Filing Requirements for Transmission and Distribution Applications dated June 22, 2011 (the June 2011 Filing Requirements) and also in the Revised Filing Requirements. The June 2011 Filing Requirements, for example, indicate that the threshold determines eligibility for "incremental capital spending";[29] that a distributor's ICM evidence should demonstrate that its "non-discretionary spending" exceeds the threshold test;[30] and that, at the time of rebasing, the Board will make a determination of any difference between "forecast and actual capital spending".[31]

23. The "Incremental Capital Workform" prescribed by the Board for ICM applications also makes clear that the ICM framework is based on a spending model. This Workform includes a page for the applicant to provide a Summary of Incremental Capital Projects (ICPs). On this page, there is a column under which the applicant is supposed to provide the dollar amounts of "Incremental Capital CAPEX".[32]

24. The next page of the Incremental Capital Workform is headed "Incremental Capital Adjustment". At the top of the page of calculations for the Incremental Capital Adjustment, the Incremental Capital Workform calls for the applicant to show

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[24] *Ibid.*
[25] *Ibid.*
[26] Supplemental Report, page 32.
[27] *Ibid.*
[28] *Ibid.*
[29] Ontario Energy Board Filing Requirements for Electricity Transmission and Distribution Applications, June 22, 2011, Chapter 3, page 10.
[30] June 2011 Filing Requirements, Chapter 3, page 12.
[31] June 2011 Filing Requirements, Chapter 3, page 13.
[32] See the Pre-filed Evidence, Tab 4, Schedule E1.1, page 11.

"Incremental Capital CAPEX" and then to deduct depreciation expense in order to derive an amount of "Incremental Capital CAPEX to be included in Rate Base".[33]

25. Toronto Hydro submitted its ICM application in accordance with the directions provided by the Board and in accordance with the Board's Incremental Capital Workform. More particularly, Toronto Hydro filed its application on the basis of the ICM spending model established by the Board.

26. Toronto Hydro's ICM application is of critical importance for reasons that relate both to funding and to risk. Toronto Hydro must invest in essential capital work in order to maintain the safety and reliability of its system and to meet the expectations of its customers with respect to safety and reliability. If Toronto Hydro does not receive funding for these critical capital expenditures in a timely manner, issues arise with respect to Toronto Hydro's cash flow, financial leverage and avoidable financing costs.

27. The importance of timely funding of Toronto Hydro's capital expenditures was addressed in oral testimony by Ms. Cheah. Her evidence on this point was, in part, as follows:

> I can make some general comments with respect to the funding. In looking actually at the Standard & Poor's rating, there's certain aspects of it that the stable A rating right now was given to us because, under the framework, it's expected that we would get prudent cost recoveries and earn a modest return on the investment of capital.
>
> It also goes further to state …
>
>> "Our expectation is the company will manage the capital expenditures in line with the OEB-approved levels. A material adverse energy or regulatory policy change or expectations of sustained financial deterioration would likely lead to a downgrade.
>
> … So … in terms of our – our ability to get financing and our ratings would be adjusted accordingly, adversely.[34]

28. Quite apart from the issue of timely funding for Toronto Hydro's capital expenditures, there is also an important issue of risk. The Board's IRM, of course, is a multi-year model and, as revealed by the evidence in this case, Toronto Hydro has very large capital spending requirements over all of the years of the term of its IRM

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[33] Pre-filed Evidence, Tab 4, Schedule E1.1, page 12.
[34] Tr., pages 197-198. See Ex. K5.2, Standard & Poor's Rating, September 20, 2012, pages 3-4. See also page 6 of the same document (bottom paragraph) and Ex. K5.2, DBRS Rating Report, September 7, 2012, page 4, fourth "bullet" under "2012 Outlook".

application. Toronto Hydro would be forced to undertake an inordinate level of risk if it were to be expected to proceed through the multi-year term of its IRM plan with this very large capital spending program, subject to a review of the capital spending that would only occur at rebasing.

29. Toronto Hydro submits that the ICM model can and should be seen as a mechanism to alleviate inordinate levels of risk in relation to capital spending. In the absence of review and approval of Toronto Hydro's capital spending by the Board prior to rebasing, Toronto Hydro would be left in a risky, if not precarious, state of uncertainty, until rebasing. The ICM model should be a mechanism that enables the Board to alleviate risk by removing uncertainty as Toronto Hydro moves ahead with capital spending during the IRM term.

30. The magnitude of Toronto Hydro's capital spending requirements over the term of its IRM plan sets Toronto Hydro apart from most or all other Ontario electricity distributors. This means that, without the availability of Board approval under the ICM framework, Toronto Hydro would be faced by levels of risk during the IRM term that are much unlike those of other distributors. Toronto Hydro therefore submits that the Board should proceed under its ICM model to ensure that Toronto Hydro will not be forced to contend, during the term of the IRM plan, with these undue levels of risk associated with uncertainty of full recovery of capital spent.

31. Further, Toronto Hydro believes that the funding and risk issues that arise in connection with this IRM/ICM application differentiate Toronto Hydro's circumstances from those of other electricity distributors. Accordingly, Toronto Hydro does not expect that a Board decision in this case would represent any form of precedent for other distributors. Simply put, the decision that the Board renders with respect to this application would only be applicable to a utility of similar characteristics to Toronto Hydro, facing similar issues to Toronto Hydro and providing the same evidentiary base, in the same level of detail, as Toronto Hydro.

4. The Board's ICM Model

32. As mentioned above, Toronto Hydro's application was filed before the Revised Filing Requirements were issued in June of 2012. In the Manager's Summary, Toronto Hydro presented a careful explanation of how its ICM proposal complies with the Board's guidelines for ICM applications.[35]

33. Since the filing of the application, the Revised Filing Requirements have become available and the Board's revisions to the filing guidelines confirm the evolving nature of the Board's thinking with respect to ICM applications. One change in the Revised

[35] Manager's Summary, Pre-filed Evidence, Tab 2, pages 14-21.

Filing Requirements is the removal of the wording in the June 2011 Filing Requirements indicating that a distributor's ICM evidence should include:

> Demonstration that the proposed non-discretionary capital projects are unusual and unanticipated.[36]

34. The removal of these words from the filing requirements is important for two reasons. First, and obviously, it is no longer the case that the Board's guidelines contemplate a demonstration in evidence that proposed ICM capital projects are "unusual and unanticipated". Second, the removal of these words from the filing requirements is further confirmation of the evolving nature of the Board's thinking with respect to the ICM model.

35. The Revised Filing Requirements reveal a clear and basic structure to the Board's ICM model. One aspect of this basis structure is that there actually are only three core "criteria" for an ICM application, namely, Materiality, Need and Prudence.[37]

36. Another aspect of the basic structure of the ICM model is that the Board has provided definition around the three core criteria: this can be found in the Board's table in the Revised Filing Requirements setting out the three "Criteria" with a "Description" for each.[38] It is in this context that the Board has indicated that the Need criterion extends only to non-discretionary spending.

37. Yet another aspect of the basic structure of the ICM model is that, in addition to the three core criteria and the descriptive wording provided by the Board for each, there is also guidance regarding evidence that "should" be filed as part of an ICM application.[39]

38. A very significant point to be noted with respect to the structure of the ICM model is that, having established a model with three criteria at its core, the Board actually has allowed itself considerable flexibility in the guidelines that come into play around the three criteria. In other words, there is no doubt that Materiality, Need and Prudence are established as core elements of the ICM model, but the filing requirements do not in any way suggest that the guidance that is provided around these three core elements must be applied rigidly.

39. Indeed the flexibility available to the Board is broader and more open than is apparent even from the words of the Revised Filing Requirements. This was made clear in the Board's EB-2008-0187 Decision with respect to an ICM application by Hydro

[36] June 2011 Filing Requirements, Chapter 3, page 12.
[37] Revised Filing Requirements, Chapter 3, page 7, top of page.
[38] Revised Filing Requirements, Chapter 3, page 7, top of page.
[39] Revised Filing Requirements, Chapter 3, pages 9-10.

One Networks Inc. (Hydro One), which Toronto Hydro understands to be the first decision in which the Board considered an application under the ICM model.

40. In the EB-2008-0187 Decision, the Board specifically noted the "regulatory flexibility" that is inherent in the ICM model,[40] but went on to conclude that it could not consider Hydro One's application under the ICM model.[41] Having reached this conclusion, the Board nevertheless allowed an increased revenue requirement to provide some funding for Hydro One's capital expenditures. The Board's reasoning as set out in the decision includes the following:

> …what is before the Board is a request for rate relief that goes to a large degree to the distributor's plan to continue serving its customers in a safe and reliable manner. … Further, there is a relatively significant gap between Hydro One's apparent capital needs in 2009 and the available funding through rates for these needs. The Board is therefore prepared to consider providing relief so as not to impair the company's ability to maintain a safe and reliable distribution system.[42]

41. The Hydro One decision was explicitly noted by the Board in the EB-2011-0144 Decision. (Again, as mentioned above, it was in the EB-2011-0144 Decision that the Board encouraged Toronto Hydro to file an ICM application for 2012.) Specifically, in the EB-2011-0144 Decision, the Board made the following comments about the relief granted to Hydro One:

> While the Board did not accept the application for relief under the ICM for Hydro One Networks Inc., it did provide substantial relief by increasing the revenue requirement by more than half of what was original requested … ."[43]

42. Toronto Hydro therefore submits that the Board's treatment of essential capital spending during the term of an IRM plan is anything but a regulatory mechanism that requires a rigid application. More particularly with respect to the ICM model, Toronto Hydro submits that the ICM is not a mechanism that is to be applied in a manner that causes it to become an obstacle to the appropriate funding of essential capital work.

43. To put it another way, the Board has taken a flexible approach to its treatment of capital spending during the term of an IRM plan and, by doing so, the Board has ensured that the structure of the ICM model does not become a barrier to funding of essential capital work during an IRM term. After all, the ultimate responsibility of the regulator is to fix or approve just and reasonable rates, that is, rates that are reasonable

[40] EB-2008-0187 Decision, page 8.
[41] EB-2008-0187 Decision, page 9.
[42] EB-2008-0187 Decision, page 9.
[43] EB-2011-0144 Decision, page 22.

for ratepayers based on the appropriate cost of providing the services that they receive and rates that allow a fair return to the regulated utility providing the services.

44. Another key point to note about the basic structure of the Board's ICM model is that the three core elements of the model, Materiality, Need and Prudence, are directly aligned with the core elements of the case presented to the Board by Toronto Hydro in support of its ICM application. The oral testimony of Toronto Hydro's witnesses at the hearing emphasized that the proposed capital expenditures are necessary to maintain the safety and reliability of the distribution system and the witnesses repeatedly elaborated on their conviction that the expenditures are material, essential and prudent.

45. In EB-2011-0178, Kingston Utilities Corporation filed an ICM application in respect of work that can be summarized as underground cable rebuild, transformer vault rebuilds and circuit breaker retrofit. The Board's decision on the application included the following comments:

> The Board is of the view that the applied-for projects are consistent with the purpose of the ICM, and that it is appropriate to evaluate the four projects using the incremental capital investment eligibility criteria.
>
> The Board finds that the need and prudence for each of the four applied-for projects, … has been established. As briefly highlighted below for each project, Kingston Hydro has provided sufficient evidence documenting asset failure, condition deterioration and safety issues to establish need and prudence in the context of this application. The Board is also of the view that Kingston Hydro has adequately demonstrated that its 2012 capital budget … is non-discretionary.[44]

46. Toronto Hydro submits that, in this case, its evidence has more than adequately demonstrated that the proposed capital spending is material, non-discretionary, essential and prudent.

5. Other Approaches

47. While, in accordance with the Board's filing requirements, Toronto Hydro submitted its application on the basis of the ICM spending model, the evidence in this case has addressed other approaches that might be considered by the Board. During the hearing, Toronto Hydro's witnesses discussed an illustrative scenario that used changes in net fixed assets as a methodology for approximation of revenue requirement impacts.[45] Toronto Hydro believes that the illustrative example based on changes in net

[44] EB-2011-0178 Decision and Order, April 19, 2012, page 18.
[45] Ex. K4.3, page 2, which was discussed at many points during the hearing, including 4Tr.67-75.

fixed assets is a useful point of comparison opposite the results that flow from application of the ICM spending model.

48. As a result of the discussion at the hearing with regard to the illustrative scenario based on changes in net fixed assets, Toronto Hydro gave an undertaking to provide a different version of the scenario. Toronto Hydro's response to this undertaking provides, in a single document, the approximate revenue requirement impacts of using: (1) the Board's ICM spending model;[46] (2) the net fixed assets approach that was discussed at the hearing;[47] and pursuant to how the company has interpreted what was requested at the hearing: (3) a variant of item 1; and (4) a variant of item 2.[48] In short, Toronto Hydro has provided four illustrative scenarios in an effort to assist the Board with reference points for the Board's consideration of the application made on a capital spending basis.

49. During their evidence at the hearing about approaches that might be taken in the Board's consideration of the ICM application, Toronto Hydro's witnesses stressed the importance of an approach that is internally consistent.[49] In other words, when a decision is made to adopt a particular methodology, it is important that the principles inherent in that particular methodology be applied consistently.

50. Toronto Hydro has filed an application in accordance with the Board's ICM spending model, it has applied principles that are based on a spending approach and it has applied these principles consistently. If, for example, an approach based on changes in net fixed assets is considered, then changes in net fixed assets should be looked at consistently from year to year. If an approach based on in-service assets is considered, then changes in in-service assets should be looked at consistently from year to year.

51. Using the ICM spending model, as Toronto Hydro has done, means that the proposed capital spending can be and is looked at in one-year "packages". Using an approach that is based on changes in net fixed assets, or in-service dates of asset additions, necessarily means that consequential inter-year effects of a given phase of the application must be considered. For example, capital spending in 2013 will not all result in changes in net fixed assets that occur in 2013, nor in additions to in-service assets that occur in 2013: some of these effects will be realized in 2014.

52. Thus, even though 2014 capital spending has been deferred to a later phase of the proceeding, an asset or rate base approach would still bring 2014 into play in this phase of the case due to 2013 capital spending that comes into service in 2014. In that event, there are two different aspects of 2014 that would need to be addressed: the

[46] From Ex. K4.3, page 1.
[47] From Ex. K4.3, page 2.
[48] Response to Undertaking J5.10.
[49] See, for example, 5Tr. 7, 24 and 39-41.

impacts of 2014 capital spending in 2014 would still be part of the later phase of this case, but the impacts of 2013 capital spending in 2014 would become part of this phase of the case, due to the inter-year implications of using an asset or rate base approach.

53. Toronto Hydro therefore submits that, in order for an asset or rate base approach to be applied on a principled and consistent basis, it is inappropriate to look at a particular year, such as 2013, in isolation. If the approach is to look at changes in net fixed assets, it must take account of all such consequential changes in net fixed assets, and if the approach is to look at assets that come into service of the ICM application, it must take account of all assets that come into service. Further, if an asset or rate base approach is taken, Toronto Hydro submits that this approach should not be mixed up with concepts and calculations that would be appropriate for a capital spending approach.

6. True-up Process

54. Under the heading "ICM Reporting Requirements", the Revised Filing Requirements state as follows:

> 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.[50]

55. Toronto Hydro is committed to developing a true-up mechanism for rebasing that will meet with the approval of the Board and it has proposed that it will work with intervenors and Board staff to develop this true-up mechanism.[51] The true-up mechanism would address either overspending or underspending in a symmetrical manner.[52]

56. In the Manager's Summary, Toronto Hydro provided its understanding of certain aspects of the true-up mechanism and stated that:

> …both ratepayers and THESL would be kept whole with respect to the approved ICM expenditures actually made by THESL … .[53]

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[50] Revised Filing Requirements, Chapter 3, page 10, paragraph 2.2.6.
[51] 5Tr.17.
[52] 5Tr.16.
[53] Manager's Summary, Pre-filed Evidence, Tab 2, page 22.

57. Toronto Hydro submits that the true-up mechanism can and should give the Board confidence that, if the ICM application is approved, ratepayers will receive the benefit of essential capital works, while both ratepayers and Toronto Hydro will be protected from the implications of underspending or imprudent overspending.

58. During the hearing, the Board expressed its interest in hearing from Toronto Hydro about the process for working with intervenors and Board staff to develop the true-up mechanism.[54] As a starting point, Toronto Hydro submits that the principles of the true-up mechanism can and must be consistent with the principles of the rate recovery methodology approved by the Board in this case.

59. Toronto Hydro contemplates that the process for working with intervenors and Board staff would take the form of a stakeholder consultation assisted by a facilitator. Should a full agreement with respect to the true-up mechanism be reached by all participants in the process, the parties would request the Board's approval of the agreed-upon mechanism. Should a full agreement not be reached by all participants in the process, Toronto Hydro would put a proposed true-up mechanism before the Board, with or without the support of some of the participants in the stakeholder process, supported by such evidence as may be needed for the Board to rule on the appropriate true-up mechanism. Toronto Hydro notes that a stakeholder consultation process along these lines gave rise to an agreement of parties that was ultimately approved by the Board in EB-2010-0231 (Enbridge Gas Distribution Inc. system reliability proceeding).[55]

60. As far as the timing of the stakeholder consultation is concerned, Toronto Hydro submits that it would be both reasonable and practical to proceed on a timeline that will allow the Board to issue its decision regarding the true-up mechanism at the time when it renders a decision on the final phase of this proceeding.

7. Ratepayer Value

61. Toronto Hydro submits that the evidence is clear that the proposed capital work program is non-discretionary, essential and prudent in order for Toronto Hydro to meet customers' expectations of safety and reliability. Toronto Hydro submits further that its proposal delivers material ratepayer value, as can be seen when the importance of maintaining the safety and reliability of the distribution system is compared to the rate impacts of the capital spending.

62 The rate impacts of the proposed capital work program were addressed in the following oral testimony by Mr. Seal:

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[54] 5Tr.141-144.
[55] EB-2010-0231 Decision and Order, August 26, 2010.

> I think the main points with respect to the rate impacts and the ICM adders that we're asking for, based on a cap-ex spend basis, I mentioned in 2012, the 2012 cap-ex results in an 86-cent increase per month for a residential customer, and the 2013 adder, a $2.27 increase for that class, on a total bill of $120 per month approximately.
>
> So even on the capital spend basis, we don't believe that the adders are excessive, at all, and reflect the spending that we need to do.
>
> And I did want to bring to the Board's attention the fact that, over the 2005 to 2012 period, distribution rates have been quite flat at Toronto Hydro for residential customers, the average annual increase of about 1.5 percent per year.[56]

63 The rate smoothing effect of Toronto Hydro's proposal was also addressed during the oral testimony. The evidence of Mr. Williams in this regard was as follows:

> As Mr. Seal just described, there's a – given the ICM adders as proposed, there would be a gradual step-up in 2012, 2013. We haven't talked about 2014, but depending on what happens there, there could be either the flat or the step-up.
>
> But I think that what it would do is it allows a gradual path towards the total amount of capital that, subject to a prudence, would be incorporated into Toronto Hydro's net fixed assets during the rebasing period.[57]

8. Conclusion

64 As elaborated upon above, Toronto Hydro has provided evidence to support a program of non-discretionary and prudent capital work to be completed over the period until 2015 that is essential to keep its system operating adequately, safely and reliably. The work that is required to be completed requires funding materially in excess of that available under IRM rates.

65. In order to proceed with this essential work, Toronto Hydro seeks the Board's approval of, first, the work program and, second, timely funding of the costs through adders to distribution rates. The only mechanism for Toronto Hydro to attain the relief that it seeks during the IRM term is an ICM application. Toronto Hydro submits that, in these circumstances, it is appropriate for the ICM to be seen as a regulatory instrument

[56] 5Tr.195-196.
[57] 5Tr.196-197.

that allows for the funding of necessary capital expenditures where there is no other mechanism available for such funding.

All of which is respectfully submitted.
December 21, 2012

[original signed by]

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