EB-2012-0064

INTHE 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

FINAL ARGUMENT OF THE CONSUMERS COUNCIL OF CANADA

JANUARY 15, 2012

1. INTRODUCTION:

By Application dated May 10, 2012, Toronto Hydro-Electric System Limited ("THESL") applied to the Ontario Energy Board ("Board") for approval for changes to its distribution rates to be effective June 1, 2012, May 1, 2013 and May 1, 2014. The application was filed pursuant to the Board's Incentive Regulation Mechanism ("IRM") framework. THESL is seeking approval of an IRM adjustment for each year, 2012-2014, including approval of an Incremental Capital Module ("ICM")for each of the three years.

By letters dated September 13, 2012, and October 22, 2012, THESL informed the Board that it would be updating its evidence. THESL informed the Board that it was undertaking a review of the extent to which the work proposed in the application, and especially that for 2012, needs to be updated and re-prioritized to account for the fact that a Board Decision would not be expected until late 2012 or early 2013.

THESL filed that updated evidence on October 31, 2012. In addition, THESL proposed that the Board deal with the application in two phases. The first phase would deal with the rates for 2012 and 2013, and the second phase would deal with 2014. The evidence regarding 2014 would be put on hold until the second phase of the hearing, and be updated to reflect the Board's Decision in the first phase and the most current forecast of the 2014 work plan with one exception. THESL requested that the Board deal with the Bremner Station Project and associated capital contributions as an integrated three-year undertaking and that Board approval for the whole first phase of this project was required at this time to enable THESL to enter into the construction and equipment supply commitments necessary to achieve completion by the end of 2014. The Board accepted THESL's proposed approach and proposed a separate process for its consideration of the Bremner Station Project (Procedural Order No. 3, dated November 8, 2012).

Following the interrogatory process a Technical Conference was held on November 21 and November 23. This was followed by an Alternative Dispute Resolution ("ADR") process which did not result in the settlement of any issues. The oral hearing was held for five days on December 10-14.

This is the final argument of the Consumers Council of Canada ("Council") on the first phase of this proceeding. The Council has been cooperating with the other ratepayer groups that have intervened in this proceeding, and in preparing this argument has been assisted by that cooperation. The Council has also taken into account the submissions filed by Board Staff.

The Council submits that the fundamental issue for the Board to decide in this case is whether THESL qualifies for ICM treatment for each of the years 2012 and 2013. If the Board determines that THESL does qualify the it must decide how much THESL is permitted to recover in each year. In considering that amount the Board must rule on whether the ICM should be calculated using in-service additions or capital spending. Furthermore, the Board must apply the appropriate criteria in deciding which projects are eligible for the ICM and how those project costs are translated into rate riders for recovery. Finally, the Board must consider how any approved ICM amounts are dealt with, from a regulatory perspective in the future.

Although it is usual practice to make final submissions consistent with the approved issues list, the Council is of the view that it would be more useful, in this case, to deal with the relevant remaining issues within the following format:

- History and Context of the Application

- Summary of the Application
- 2011 Rate Base
- The Incremental Capital Module
- 2012 and 2013 ICM
- Deferral and Variance Accounts
- Implementation

The Council notes that THESL is making this application in the context of the Board's Incentive IRM framework and the ICM. As with other ICM applications the Council believes that is imperative for the Board to make decisions in this case consistent with its well-established IRM policies. This is especially significant given the Board's recently issued Renewed Regulatory Framework Report and its decision to continue with one rate-making option (among others) that is, in large measure, a continuation the 3rd Generation IRM. For the Board to amend or move off of its current policies, in deciding upon this application, would represent a dangerous precedent, and leave the door open for LDCs to continually to seek exemptions to the policies in the future.

The Council urges the Board to ensure that, only in exceptional circumstances, will it move off of its established IRM policies. As set out below, the Council does not believe that THESL has demonstrated that it is facing exceptional circumstances, and therefore should not be exempted from being held to the requirements of the current IRM.

2. HISTORY AND CONTEXT OF THE APPLICATION:

THESL's capital plans have been the subject of many rate applications over the past 5 years. As a general observation the Council submits that there has been no consistent long-term strategy adopted by THESL to address its capital needs or report on how those needs are being met. In addition, there has been no consistency or matching between what has been filed in previous cases, what was agreed to in Settlement Agreements and what was actually spent. Furthermore, the format in which the capital expenditures have been presented in this application, relative to previous years, is substantially different.

In 2007 THESL applied on a Cost of Service basis ("COS") for the three-year test period 2008-2010. The Board approved rates for 2008 and 2009 also approving capital expenditures of

$230 million for 2008 and $240 million for 2009. In its Decision, the Board stated that, "..the Board finds elsewhere in this Decision that the Applicant has been able to demonstrate a need for measures to address a material underinvestment in infrastructure over the recent past. The evidence which consisted of third party reports, and testimony by Company witnesses, established that there are legitimate concerns respecting the condition of certain important elements of the asset base, particularly underground cable and certain transformer stations. (Decision, EB-2007-0680, pp. 3-7). THESL`s actual capital expenditures for 2008 were $205 million and $241 million in 2009 (Ex.6B/6-9/p. 2)

In 2010 THESL applied for approval of capital expenditures of $423 million. THESL indicated in that case that a significant "catch up" in expenditures for 2010 was required (Ex. D1/T7/S1/p. 18). Nevertheless, THESL agreed through the Settlement Agreement to a level of $350 million and actually spent $381 million. In 2011 THESL applied for a capital budget of $498 million. The 2011 amount agreed to through the Settlement Agreement was $378.8 million (Ex. 6B/S 6-10) THESL's actual 2011 expenditures were $445 million (Ex. 6B/S6-9)

In 2011 THESL 's evidence was that it was continuing to present sustaining investments in distribution plant in six main investment areas or portfolios consistent with the Capital Plan and as shown in earlier applications. These included underground replacement of direct-buried cable; underground system cable in duct rehabilitation; overhead systems; network system; transformer stations and municipal stations (Ex. D1/T7/S1/p. 2 EB-2010-0142).

On August 26, 2011 THESL applied to the Board for approval of rates effective May 1, 2012, 2013 and 2014. It was a prospective three-year cost of service application. The Board decided to consider a preliminary issue before considering the full application. That issue was whether the application should be accepted or dismissed, based on a consideration of the early rebasing criteria that have been establish by the Board.

THESL had argued that the 3rd Generation IRM ("3GIRM") did not work for THESL because of the level of its capital expenditure requirements and workforce renewal needs. With respect to employing the ICM THESL's position was the following:

> 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. (EB-2011-0144, Witness Statement of Colin McLorg, p. 14)

In that Application THESL was proposing the following capital budget for the three-year period:

2012 $590 million
2013 $615 million
2014 $640 million (EB-2011-0144/Ex. D1/T8/p. 5)

The Board determined that THESL had not met the test for a departure from the 3GIRM policy. The Board dismissed the application, but encouraged THESL to file an IRM application for 2012, including an ICM (Decision, EB-2011-0144, p. 15). Furthermore, the Board indicated that its thinking with respect to the ICM had evolved and in recent decisions it had granted relief for "discrete, material and non-discretionary projects which cannot be funded through the normal operation of the 3GIRM mechanism" (Decision, EB-2011-0144, p. 22). In addition, the Board stated:

> While the Board cannot determine at this time the level of spending under THESL's capital plan that would be eligible for the ICM, it appears that two projects, the Bremner station and contributions to Hydro One Networks for the Leaside Birch transmission reinforcement (which together total $86.6 million in 2012), are directly analogous to projects that the Board previously approved under ICM for other distributors. (Decision, EB-2011-0144,p. 22)

It is clear, the Council submits, the Board was encouraging THESL to file an IRM application to obtain relief for projects that were "discrete, material and non-discretionary", similar to the Bremner and Leaside projects and directly analogous to those approved for other LDCs. As set out below, the Council is of the view that the nature of the "projects" THESL has proposed for its ICM, are in large measure, not those type of projects. As noted above, the majority of THESL's capital requirements indentified in 2011 were "routine, core business requirements of a distributor." From the Council's perspective these requirements have not changed, but have been re-characterized as projects, segments and jobs.

THESL filed its application in May 2012, seeking approval of capital spending of $448.7 million for 2012 and $534.5 million for 2013. The updated numbers, as at October 31, 2012, are $274 million for 2012 and $579.1 million for 2013 (Tr. Vol. 1, p. 29)

The Council submits that in the past THESL has a poor track record with respect to demonstrating to the Board its capital requirements, the funding necessary, and its ability to execute work plans to address those requirements. This is important context as the Board considers the budgets currently before it and the request for ICM relief. Examples of this include:

- In 2010 and 2011 THESL agreed to settle on amounts significantly below the amounts they applied for as "essential" spending requirements. THESL, in effect, decided to forego funding for what it deemed, in its applications, as necessary. The amounts spent were again different than what was reflected in those settlements. THESL now claims that they absolutely need incremental funding, beyond the amounts they agreed to in 2011;
- In it rebasing application THESL's forecast for required capital spending was $590 million for 2012. In the ICM application filed in May, that amount was reduced to $448.7 million and is now at $274 million. The most updated 2012 number is $283 million. As a result of the Board's Decision on the Preliminary Issue, THESL issued a "stop work notice" essentially halting it most of its work programs, rather than proceed with what it had deemed essential work. (J1.3). The current numbers are a reflection of THESL's decision to review its ability to execute its work plan (Tr. Vo. 1, p. 30). This simply goes to the point that there is a continuous disconnect between what spending THESL deems urgent, required and non-discretionary relative to what it actually carries undertakes.

The Council submits that a review of THESL's capital planning and spending history before the Board is relevant to this application. THESL decided to forego revenue in 2010 and 2011 despite its forecast of capital spending for each of those years. Again, the projects that were deemed necessary and required in 2012 have not only been deferred, but the entire capital program has been reformatted and presented in an entirely different manner. The Council submits that this puts THESL's claim that all of the applied for projects, segments and jobs for 2012 and 2013 are non-discretionary and urgent in serious doubt.

3. SUMMARY OF THE APPLICATION:

In the original evidence, filed May 10, 2012, THESL indicated that the ICM component of its application represented a request for resources critical for THESL to bridge the gap to its next rebasing and Cost of Service Application anticipated to occur in 2015. The evidence stated that, "The specific projects THESL includes within the ICM reflect the minimum amount of infrastructure renewal THESL <u>must</u> undertake over the next three years to maintain current overall levels of system safety and reliability (emphasis added)." (Ex. T2/p. 2 original)

THESL also indicated that although it had prepared its application in accordance with the IRM/ICM guidelines, directions and decisions from the Board it does, with respect to certain matters, either propose modified approaches to address distinctive needs, or new approaches in cases where the Board has not expressly pronounced on particular issues. THESL identified the following "Special" issues where it is seeking approval of a modified and/or new approach relative to the Board's ICM/IRM framework:

a) <u>Recognition in Rates of Approved Year-End Rate Base:</u> The proposal is to recognize in 2011 rates the Board approved actual year-end rate base for 2011, and not the 20111 rate base upon which 2011 rates were set (1/2 year rule).
b) <u>Three year Period:</u> The proposal is to apply the ICM for a three-year period, severable into three successive on-year rate periods, each with its own ICM rate adder;
c) <u>Determination of Revenue Requirements:</u> An alternative to the calculation of the ICM threshold and the practice of exempting ICM approved expenditures from the application of the half-year rule, except in the year directly preceding rebasing. The ICM threshold would be calculated in accordance without the 20 dead band, thus representing approved depreciation in the rebasing year adjusted by growth and the PCI. The rate adders would be average incremental ICM investment in that year using the half year rule;
d) <u>Application of the ICM Criteria</u>: THESL set out its interpretation of the criteria and how its projects satisfy that criteria;

e) Interim Rates, Implementation of Rates, and True-Up upon Rebasing: The request is for rates effective June 1, 2012. In addition, the proposal is to, upon rebasing true up the revenue requirement flowing from the ICM projects with the revenues actually received. (Ex. T2/pp. 3-23, original)

THESL's evidence is that in rate applications since 2007 it had provided detailed documentation of its long-term infrastructure renewal program. That program has been ongoing for several years with Board approval, and THESL believes that it must continue, at least at a pace the prevents further worsening of the condition of its distribution system (Ex. T2/pp. 8-9). THESL also noted that while there have been some changes in the work proposed in EB-2011-0144 which reflect the passage of the time, the ICM projects now proposed" substantially represent the subset of work previously proposed that THESL considers essential over the immediate term" (Ex. T2/p. 24).

THESL presented it capital program in a way that differed from the presentation in the past. Capital expenditure categories have essentially become "projects" which are further divided into "segments" and "jobs". What has been included in the new submission has no direct relationship to previous submissions (Tr. Vol. 1, p. 33). This is true, at least with respect to cost categories, but as the Council will argue below, not necessarily true regarding the nature of the activities that THESL intends to undertake.

In the original application THESL's Capital expenditure forecast for 2012 was $448 million and for 2013 $534 million. In the October update the 2012 budget was $274 million for 2012 and $579 million for 2013 (Ex. T4/SA/Appendix 1/p. 1/original and updated). With respect to the ICM amounts THESL was seeking incremental revenue requirements of $28.6 million, $36.0 million and $13.5 million for the years 2012, 2013, and 2014. In the October update the revenue requirements requested, to be recovered through the rate riders, were $10.1 million for 2012 and $39.9 million for 2013 (Ex. T4/SA/p. 1).

In May it was critical that THESL spend $448 million in 2012, but by October that budget had been reduced to $274 million.

THESL provided an "Addendum to the Manager's Summary", dated October 31, 2012 setting out the nature and underlying rationale for THESL's evidentiary updated for 2012 and 2013. THESL indicated that the update is fundamentally administrative in nature, representing a shifting of certain jobs between ICM years in order to reflect the passage of time and operational experience since the Application was filed in May (Ex. T2/Addendum/p. 20) It is THESL's view that the work plan described in the update conforms to the requirements and intent of the ICM as it has evolved over time, including the relevant ICM factors, such as need and prudence.

4. 2011 RATE BASE:

THESL is seeking approval for the Board to recognize the Board approved, actual year-end rate base for 2011 in the amount of $37.9 million (or $12.9 million per year). THESL is seeking a rate rider to calculate the revenue requirement related to the declining balance of these amounts for each year until rebasing (Ex. 1/p. 6). This is not consistent with the way in which 2011 rates were set, which as is typical in a cost of service year, rate base is based on the half year rule.

THESL's position on this issue is a follows:

> To the extent that year-end ratebase for the rebasing year materially exceeds the average rate base used for the purpose of setting rebasing year rates, the difference between year-end and average rate base is unrecognized under IRM and is uncompensated in rates for the subsequent years until the time of THESL`s next rebasing. Further, at the time of that rebasing, only the depreciated balance remaining in net fixed assets is eligible for inclusion in rate base.
>
> ...In summary, the operation of the half-year rule in THESL`s circumstances would result in a permanent loss of approximately $38 million dollars over the balance of the IRM term, unless remedied by the Board (Ex. T2/pp. 5-6)

From the Council's perspective, THESL's proposal is clearly inconsistent with the Board's policy regarding IRM . That policy has been soundly articulated through the following:

1. The Board's initial Report on Performance Based Regulation (EB-1999-0034);
2. The Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, dated July 14, 2008;
3. The Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors dated September 17, 2008 (EB-2007-0673);

4. Report of the Board - A Renewed Regulatory Framework for Electricity Distributors: A Performance Based Approach dated October 18, 2012; and
5. Various ICM applications approved by the Board.

More recently, in two recent Decisions the Board has rejected the approach put forward by THESL. In the PowerStream Inc. Decision the Board stated:

> The use of the half-year rule for depreciation is a long-standing policy of the Board. the policy was recently reviewed in the context of the RRFE and remains unchanged in this area. The Board finds that PowerStream has not justified its request for full year depreciation and does not accept it...It is clear to the Board that the nature of the issue is generic. the half year rule is integral to the Board's rate making framework and is generally applied to all distributors. The manner in which the Board applies its policies is to allow for departures from the normal practice where the specific circumstances of any given situation dictate that an alternative approach would be more appropriate. The examples cited by PowerStream where the Board applied something other than the half year rule are illustrative of the typical outcomes that can result from the consideration of the specifics of a given situation. PowerStream has not provided evidence of any specifics of a given situation. PowerStream has not provided evidence of any specifics that would warrant a departure from the normal practice of applying the half-year rule. (Decision and Order of the Board, dated December 12, 2012, EB-2012-0161)

Enersource Hydro Mississauga was seeking essentially a two-year cost of service application. Once rates were set for 2013, rates would be set for 2014 based on a number of adjustments including the full-year impact of the 2013 rate base. The Board rejected this approach and stated:

> ..One of the central principles of incentive ratemaking frameworks is the separation of costs from price. Multi-year incentive schemes are established without an annual recalibration of rate base. (Decision and Order dated December 13, 2012, EB-2012-0033)

From the Council's perspective the Board's policy with respect to the use of the half-year rule for ratemaking is clear. IRM allows for recovery of costs beyond depreciation through the PCI and is meant to incent opportunities for efficiency gains and cost-minimizing strategies. Allowing for elimination of the half-year rule in this case would be to apply a cost of service approach within the context of an IRM. The Council urges the Board to reject THESL's proposal to recognize the full-year impact of its 2011 approved rate base in 2012 rates.

5. THE INCREMENTAL CAPITAL MODULE:

Since it was first proposed, and eventually introduced, there have been many differences of opinion as to the purpose of the incremental capital module. The Board in it Supplementary Report issued on September 17, 2008, set out, its view, at that time:

> 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 capital relief. (Supplementary Report, p. 31)

The Board set out criteria for ICM eligibility - materiality, need and prudence. With respect to need, the Board requires that amounts should be directly related to the claimed driver, which must be non-discretionary. In addition, the amounts must clearly be outside of the base on which rates were derived.

The Board has since issued decisions that comment on the criteria. In the Board's EB-2011-0144 Decision the Board acknowledged that it had evolved its thinking, and granted rate relief for discrete, material and non-discretionary projects which cannot be funded through the normal IRM mechanism.

6. 2012 AND 2013 ICM

Do the expenditures proposed qualify for the ICM?

THESL retained two consulting firms, Navigant Consulting Ltd. ("Navigant") and Power System Engineering Inc.("PSE") to review its business cases prepared for the ICM filing. The ten business cases reviewed by PSE deal primarily with proposed capital improvements that are rooted in reliability concerns. PSE performed a high-level review of these business cases, focusing on overall methodologies and strategies. (Ex. T4/SD4) Navigant was asked as well to conduct an independent review of eleven specific business cases that THESL prepared to support is ICM application (Ex. T4/SD5).

The Council does not necessarily take issue with the conclusions provided by each of the consultants. Navigant found, that at a high level each of the projects were needed based on reliability, system performance requirements, and safety. (Tr. Vol. 1, p. 158) PSE found that

THESL was conducting a ground breaking approach to reliability driven projects and that, from a high level perspective, the projects are needed (Tr. Vol. 1, p. 159).

The Council does, however, caution the Board that when considering these conclusions, and how they impact the request for an ICM in both 2012 and 2013, it is important to recognize, first that these analyses were admittedly performed by the consultants at a high level (Tr. Vol. 1, pp. 158-159). The consultants took the business cases prepared by THESL and assessed them, but did not undertake any independent analyses. In addition, they were not asked to provide a review to assess the proposed timing of the projects considered (Tr. Vol. 1, p. 173). Furthermore, PSE indicated that it was not asked to provide a review of the ten business cases for the purposes of determining they were non-discretionary (Tr. Vol. 1, pp. 170-171).

Form the Council's perspective THESL has presented capital budgets for 2012 and 2013 that, although in a different format than in previous years represent typical capital spending. THESL has maintained that all of the work proposed in the filing is not entirely new in nature as the assets have remained the same and the realities of its system have remained the same (Tr. Vol. 1, p. 33). As summarized by the Chair, "the witnesses have said that the nature of their infrastructure has not changed. The nature of the issues they face with their infrastructure has not changed." (Tr. Vol. 1, p. 37). As Mr. Paradis indicated that the majority of programs would be in alignment with THESL responsibilities as a distributor (Tr. Vol. 1, p. 40).

For both years THESL is essentially saying to the Board "please fund all of our capital spending above the threshold". The Board cautioned against this approach in the Supplementary Report:

> Ratepayer groups perceive the capital module as a mechanism aimed solely at addressing extraordinary or special CAPEX need s 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 as-needed basis to accommodate increases in rate base. In the Board's view, the distributor's 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...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. (Supplementary Report, p. 31)

The Council submits that THESL's capital program does not differ significantly than what it has undertaken in the past . When encouraged to file for an IRM with and ICM by the Board the Board referred to two major projects that would likely qualify for ICM treatment, the Bremner Station project and the Leaside Birch transmission project. In other ICM application the applicants were approved for discrete projects like transmission stations. The Council submits that this type of large and discrete project is the type of project envisioned by the Board when it was developing the ICM framework. Approval is other ICM applications solidify this point. The projects, segments and jobs identified by THESL are not consistent with the spirit of the ICM framework. Therefore, the projects proposed should not qualify for ICM treatment.

To the extent the Board is of the view that the projects proposed should be considered in the context of determining an ICM the Board needs to address the following issues:

1. Should the ICM be based on capital expenditures or in-service additions?
2. Has THESL met the materiality threshold in 2012 and 2013?
3. What specific criteria should the Board apply in assessing the which projects above the threshold qualify for ICM treatment?
4. Do THESL's projects/segments/jobs meet the criteria?
5. How should the true-up mechanism operate?

Should the ICM be based on capital expenditures or in-service additions?

With respect to the issue of using capital expenditures in a given year vs. in-service additions THESL is of the view that its forecast of capital expenditures is the appropriate way to calculate and IRM ICM. THESL, in its argument in chief, referred to a number of examples where the term CAPEX has been used. These include the Board's original Report of the Board on 3rd Generation Incentive Ratemaking for Ontario's Electricity Distributors, the Supplemental Report, the Board's Fling Requirements for Electricity Transmission and Distribution Applications and the Incremental Capital Workform prescribed by the Board for ICM applications (Argument in Chief, pp. 5-6). The Council acknowledges that the term CAPEX and capital spending have been used throughout these documents. Going forward the Board needs to clarify this and distinction and ensure the correct terminology is incorporated into the relevant documents.

The Council submits, however, that there should be no question as to whether the ICM should be based on an "in-service" methodology. Although THESL claims the appropriate approach should be to use forecast capital expenditures when running the ICM model, this approach is not consistent with past Board practice. In each of the ICM applications that have been approved by the Board the in-service approach has been adopted.

From a ratepayer perspective THESL's approach is simply unfair. The result of using that approach would be to compensate THESL for capital spending that was not in-service. This approach is inconsistent with generally accepted rate-making principles. In addition, as the ICM is calculated on a revenue requirement basis, using in-service additions is the way in which revenue requirement is properly determined.

THESL has argued that to the extent an in-service model is adopted then it would be necessary to take into account in subsequent years impacts of in-service additions from the projects approved through an ICM (when a project is approved in 2013, for example and there is an in-service impact in 2014, this should be accounted for). The Council does not take issue with that approach.

The Council, therefore acknowledges that there can be some confusion about the use of capital expenditures vs. in-service addition given the various policy documents refer to "CAPEX". The Council is of the view that this needs to be clarified by the Board, and going forward guidelines and directives be clear that using in-service additions is the appropriate approach.

Has THESL met the materiality threshold in 2012 and/or 2013?

2012

The practice that has been adopted by the Board in previous cases (and most recently in the Hydro One Distribution Settlement Agreement approved by the Board - EB-2010-0136) is to use in-service additions in calculating the threshold. Assuming a threshold of $173 million, which is not at issue in the proceeding , and capital in-service additions for 2012 of $116.3 million. Under this approach It is clear that THESL has not met the threshold and should not be allowed an ICM for 2012.

There is an argument to be made that in-service additions for 2012 should reflect the Construction Work in Progress ("CWIP") from 2011 that goes into service in 2012. The Council is not opposed to that approach, but has two concerns.

THESL has indentified $67 million of CWIP from 2011, that was expected to come into service in 2012 (J5.1). In order for those amount to qualify for ICM treatment, it must be assessed on the basis of the same criteria that is being used to assess the 2012 in-service amounts. THESL did not provide evidence in this proceeding that these amounts represented expenditures or projects that are non-discretionary. 2011 was a cost of service proceeding and in the absence of such evidence, these amounts should be considered normal "business as usual" capital expenditures. Without clear evidence that the $67 million is non-discretionary 2012 is not eligible for ICM treatment.

If the Board adopts the in-service approach for calculating the threshold, including the 2011 CWIP amounts the amount available for an ICM is approximately $10 million. This assumes a threshold of $173 million and in-service additions for 2012 (including $67 million in CWIP) of $183.3 million (J5.1). The Board must then determine how much of the $183 million is truly non-discretionary.

2013

Again, for 2013, the threshold as determined by the Board's policy for 2013 is $173 million. THESL's proposed capital spending for 2013 is $579 million. Under THESL's proposal the amount it is seeking for ICM treatment is $406 million. If the THESL's forecast of in-service additions are used to calculate the amount available for ICM treatment, the amount approved for ICM treatment should be $296.8 million ($469.8 million-$173 million)). This includes 2011 CWIP that comes into service in 2013 of $45.46 (Ex. J5.1).

The Council submits that, as noted above, with respect to 2012, in the absence of clear evidence that the 2011 expenditures were non-discretionary, they should not be included in the calculation of the amount potentially available for ICM treatment. Excluding the 2011 CWIP amounts the Council submits that this would result in a potential ICM of $251.3 ($469.81 million -$45.46 million) (Ex. J5.1). The Board must then assess, to what extent those expenditures are non-discretionary.

What specific criteria should apply in assessing the projects above the threshold that should qualify for ICM treatment?

The Board set out in the Supplemental Report on 3rd GIRM it views as to what criteria should apply in assessing amounts qualify for ICM. These are "materiality, need and prudence." Within the context of these criteria the Board set out that the amounts should be directly related to the claimed driver which must be "clearly non-discretionary". In addition, the Board pointed to the fact that in the context of prudence the distributor's decision to incur the amounts must represent the most cost-effective (not necessarily least initial cost) for ratepayers. It is also important to point out that in terms of need the Board indicated that the amounts must be clearly outside of the base upon which rates were derived. (Supplemental Report p. 33)

In the THESL's rebasing application the Board indicated that its thinking with respect to the ICM had evolved and in recent decisions it had granted relief for "discrete, material and non-discretionary projects which cannot be funded through the normal operation of the 3GIRM mechanism" (Decision, EB-2011-0144, p. 22). As noted above, the Board pointed to two large projects, Bremner and Leaside Birch as examples of what would qualify for ICM treatment.

In this case THESL also noted that while there have been some changes in the work proposed in EB-2011-0144 which reflect the passage of the time, the ICM projects now proposed" substantially represent the subset of work previously proposed that THESL considers essential over the immediate term" (Ex. T2/p. 24).

The Council submits that the "projects, segments and jobs" proposed in this application are not what was envisioned when the Board developed the ICM model. THESL has not presented discrete projects that are outside of its normal business activities, but rather expenditures intended to support ongoing capital spending requirements. The Council does not support ICM treatment for either year. As discussed earlier THESL is applying the ICM framework to say to the Board - fund all of our capital expenditures beyond the threshold. THESL has effectively repackaged the 2012 COS capital program as its proposed ICM expenditures.

To the extent the Board intends to consider the expenditures filed in support of the projects, segments and jobs the Council is of the view that when considering projects that exceed the materiality threshold the Board must continue to rely on the criteria of materiality, need and prudence. This includes the criteria, that the amounts must be clearly outside of the base on which the rate were derived. With respect to what entails non-discretionary, it is important from the Council's perspective to demonstrate that the project must be done within the IRM period. It becomes a test not only of whether the project is truly non-discretionary, but a test as to whether the project must be undertaken now, during the IRM period.

Do THESL's project/segments/jobs meet the criteria?

As noted above, to the extent the Board considers THESL's application for 2013 for ICM treatment appropriate, the maximum amount available to THESL should be $296.8 million subject to the Board applying the criteria on a project by project basis. The Council has not undertaken a line by line approach and attempted to apply that criteria to each project, segment and job. The Council has reviewed the analyses undertaken by Board Staff, Energy Probe, the Association of Major Power Consumers in Ontario, Energy Probe and the Vulnerable Energy Consumers Coalition. The Council urges the Board to carefully consider those submissions, from a technical perspective, in assessing how it applies the criteria to determine an appropriate IRM for 2013. Those analyses clearly demonstrate that THESL's full request for 2013 should not be approved, as many of the segments and jobs proposed do not meet the required ICM criteria. Some of the work is clearly not required, and some it deemed necessary could be deferred.

The Board must consider the non-discretionary nature of the expenditures, but equally important is that the Board must consider whether those expenditures are absolutely required during the ICM period. These two criteria are the most critical from the Council's perspective for the Board to apply in reviewing the reasonableness of THESL's proposals.

Once the Board makes its determination as to what expenditures should be approved for the 2013 ICM, THESL should be required to come back with it proposals as to how those approvals translate into revenue requirement amounts and ultimately how they are translated into the calculation of the rate riders. This will be important, as well, in order to facilitate the required "true-up" process upon rebasing.

7. DEFERRAL AND VARIANCE ACCOUNTS

PILS Deferral Account

The Council has reviewed the submissions of Board Staff regarding the PILS Deferral Account (1562) and supports those submissions. In effect, the Council supports the disposition of the revised credit balance of $7 million and debit carrying charges to December 31, 2012 0f $46,000.

Group 1 Deferral Accounts

The Council supports THESL's proposals with respect to the disposition of the Group 1 Deferral and Variance accounts and the rate riders.

8. IMPLEMENTATION

Suite-metering

In the final order arising out of the EB-2010-0142 proceeding the Board set out a number of directives regarding the establishment of the new Suite-metering rate class. The Council submits that THESL has appropriately addressed the Board's requirements.

Effective Date for 2012

THESL has proposed an effective date of June 1, 2012, for its 2012 rate adjustment. The Council has some concerns about the effective date for the following reasons. A final rate order in this proceeding will likely not be issued for a number of months. That means that any adjustment to 2012 rates will be retroactive back to June 1, 2012, potentially almost a year after the fact. Although the "shortfall" associated with any rate adjustment will be recovered prospectively THESL is seeking to recover revenue back to June 2012. THESL's customers are being required to pay more for electricity consumed almost a year earlier. The Council is of the view that at times some retroactive recovery is required, but in this case THESL was, to some extent, responsible for delays in the process.

A Board Decision was issued in early January 2012. THESL applied for a motion for review and an appeal to the courts. This contributed to the delay in the process. In addition, on October 31, 2012, THESL filed an extensive evidence update. The evidence update essentially reconfigured the filing and involved material changes to the original proposals. This initiated the need for further procedural steps.

As a compromise, the Council supports an effective date of November 1, 2012. This does not fully avoid a retroactive adjustment, but also recognizes that THESL was not fully responsible for the timing of the process.

ICM True-up Process

The Board's Supplemental Report includes the following statement with respect to reporting requirements:

> 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.

The Council submits that in order for the true-up mechanism to be effective there will need to be a link, on a "job by job" basis, or alternatively on "segment by segment" basis between what is "approved" spending by the Board and the actual spending at the time of rebasing. This will depend upon the Board's decision. THESL should be required, once the Board's Decision is issued to come back with proposals reflecting the revenue requirement impacts of the Board's findings.

9. COSTS

The Council submits that it be awarded 100% of its reasonably incurred cost for this proceeding. The Council has acted responsibly in this proceeding, working with others and proceeding in a cost-effective manner.

All of Which is respectfully submitted

Julie Girvan
Consultant to the Consumers Council of Canada