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January 15, 2013

Ms. Kirsten Walli  
Board Secretary  
Ontario Energy Board  
P.O. Box 2319  
2300 Yonge St.  
Toronto, ON  
M4P 1E4

Dear Ms. Walli:

**Re: Vulnerable Energy Consumers Coalition (VECC)**  
**Final Submissions: EB-2012-0064 (Phase 1)**  
**Toronto Hydro Electric System Limited – 2012-2014**  
**Electricity Distribution Rate Application**

Please find enclosed the submissions of the Vulnerable Energy Consumers Coalition (VECC) in the above noted proceeding.

Thank you.

Yours truly,

Michael Janigan  
Counsel for VECC

cc: Toronto Hydro Electric System Limited

**ONTARIO ENERGY BOARD**

**IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch.B, as amended;**

**AND IN THE MATTER OF an Application by Toronto Hydro-Electric System Limited pursuant to section 78 of the *Ontario Energy Board Act* for an Order or Orders approving just and reasonable rates for electricity distribution to be effective June 1, 2012, May 1, 2013 and May 1, 2014.**

**FINAL SUBMISSIONS**

**On Behalf of The**

**VULNERABLE ENERGY CONSUMERS COALITION (VECC)**

**January 15, 2013**

# Vulnerable Energy Consumers Coalition (VECC)

## Final Argument

### The Application

1. On January 5, 2012 the Board issued a Decision regarding Toronto Hydro-Electric System Limited's ("THESL") earlier request for rates effective May 1, 2012, May 1, 2013 and May 1, 2014 based on a three year prospective cost of service application. In its Decision<sup>1</sup>, the Board dismissed THESL's application but encouraged the Company to file an IRM application for 2012, including an Incremental Capital Module (ICM) application.
2. On May 5, 2012 THESL filed an application for rates effective June 1, 2012, May 1, 2013 and May 1, 2014 based on the Board's incentive regulation mechanism (IRM) framework. This application included an ICM application. It also included requests for the approval of revised Retail Transmission Service Rates and the disposition of outstanding balances in various deferral and variance accounts. Finally, the application responded to various matters outstanding from the Board's EB-2010-0142 Decision regarding suite metering issues<sup>2</sup>.
3. On August 16, 2012 the Board set out an Issues List and provision was made for an interrogatory process. Subsequent to this, THESL updated its evidence and proposed that the application be bifurcated into two phases<sup>3</sup>. The first would include the activities and rates for the years 2012 and 2013. The second phase would then deal with the 2014 rates. The Board accepted this approach but also adopted a separate "track" with respect to the Bremner Station project, apart from the phase 1 process.
4. Following a technical conference, a settlement conference and an oral hearing, the Board set a timetable for filing of final arguments regarding phase 1. These are the final submissions of VECC with respect to the issues as they pertain to phase 1.

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<sup>1</sup>EB-2011-0144, page 15

<sup>2</sup>Pre-filed Evidence, Tab 1, pages 6-7

<sup>3</sup>October 31, 2012 Evidentiary Update

The submissions are organized in accordance with the Board's Issues List.

## **ISSUE 1 Incentive Regulatory Mechanism ("IRM) Schedules and Models**

### **1.1 Are the IRM Model filings by THESL, including the tax sharing proposal for 2012, in accordance with the Board's requirements and, if not, are any proposed departures adequately justified?**

#### *THESL Application*

5. As part of its Application, THESL has filed the various work forms (i.e. IRM Generator, Tax Sharing and RTSR Adjustment) required as part of an IRM application<sup>4</sup>. Also, as part of its ICM application, THESL filed the required ICM work forms<sup>5</sup>. In response to interrogatories, various corrections have been made to the models and revised versions provided.

#### *VECC Submissions*

6. VECC submissions under Issue 1.1 are limited to those IRM model filings provided in Tab 3 of the Application. The model filings associated with the THESL's ICM application will be addressed under Issue 2.1.

7. VECC has no concerns regarding THESL's IRM model filings subject to the incorporation of the various corrections acknowledged to date. However, VECC notes that the 2013 RTSR model will need to be updated to reflect the recently approved 2012 Uniform Transmission Rates and the 2013 IRM Rate Generator model will need to be updated to reflect the 2012 over 2011 change in the GDP-IPI scheduled to be published by Statistics Canada prior to March 2013. THESL has already acknowledged the need for the latter update<sup>6</sup>.

### **1.2 Is THESL's proposal that the Board approve under the IRM framework separate and successive ICM revenue requirements and corresponding distinct electricity distribution rates and rate adders for each of the 2012, 2013 and 2014 rate years appropriate?**

#### *THESL Application*

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<sup>4</sup>Pre-filed Evidence, Tab 3, Schedules C, D and E

<sup>5</sup>Pre-filed Evidence, Tab 4, Schedules E1 - E3

<sup>6</sup>VECC IR #121

8. THESL's original application included both ICM models as well as IRM Rate Generator models for 2012 through 2014<sup>7</sup>. In its subsequent evidentiary update the Company revised the 2013 models and indicated that the materials for 2014 would be subject to future update<sup>8</sup>. In response to interrogatories, THESL indicated that while it was seeking approval, at this time, for the proposed 2012 and 2013 ICM rate riders and the 2012 IRM distribution rate adjustment, the approval of the 2013 IRM distribution rate adjustment would have to await the release of the PCI factor for 2013<sup>9</sup>.

#### *VECC Submissions*

9. VECC's submissions regarding THESL's request for approval of ICM rate riders for three years (now two years) of capital spending are provided under issue 2.3. While the original request for three-years of IRM distribution rate adjustments may have appeared extraordinary, VECC appreciates that it was necessary in order to provide the framework for THESL's three-year ICM application. Furthermore, THESL indicated that the actual IRM adjustments for 2013 (and 2014) would be the subject of future applications made at the appropriate time<sup>10</sup>.

10. However, given the evidentiary update (which limits the immediate consideration to rates for 2012 and 2013) along with the passage of time, VECC sees the Board's joint consideration of the 2012 and 2013 IRM distribution rate adjustments as being the only practical way to proceed.

### **1.3 Is THESL's proposal that the Board recognize in rates THESL's approved 2011 year-end rate base appropriate?**

#### *THESL Application*

11. In its initial application THESL requested that<sup>11</sup>:

*the OEB recognize the OEB-approved, actual year-end ratebase for 2011 in the amount of approximately \$37.9 million, and approve a rate rider calculated*

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<sup>7</sup>Pre-filed Evidence, Tab 3, Schedule C

<sup>8</sup>Updated Evidence, Tab 2 Addendum, page 3

<sup>9</sup>VECC IR #11

<sup>10</sup>VECC IR #11

<sup>11</sup>Pre-filed Evidence, Tab 1, page 6.

*to recover the revenue requirement related to the declining balance of these amounts for each year over the period until rebasing;*

12. THESL's rationale is that<sup>12</sup>

*“under the IRM framework distribution rates in subsequent years are based on average ratebase for the rebasing year (2011 in THESL's case) escalated for the subsequent years by the IRM-PCI factor ...to the extent that year-end ratebase for the rebasing year materially exceeds the average ratebase used for the purpose of setting rebasing year rates, that difference between year-end and average ratebase 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 ratebase”.*

13. In its Application, THESL has characterized this as one of the issues that the Board has not pronounced on and where THESL sought to offer suggestions/proposals<sup>13</sup>.

#### *VECC Submissions*

14. In VECC's view THESL is attempting to extend the principles of cost of service regulation into the IRM period, which is totally inappropriate. THESL has noted that under cost of service regulation differences between average and year-end rate base are captured in the next year<sup>14</sup> and this is effectively what THESL is trying to do regarding its 2011 rate base.

15. However, THESL's application for rates for 2012-2014 rates is based on the Board's incentive regulation framework which is fundamentally different from cost of service. This difference was noted by the Board in its original 2000 Report on Performance Regulation<sup>15</sup>:

*the Board observes that PBR is not just light-handed cost of service regulation. For the electricity distribution utilities in Ontario, PBR represents a fundamental shift from the historical cost of service regulation. It provides the utilities with incentive for behaviour which more closely resembles that of competitive, cost-minimizing, profit-maximizing companies. Customers and shareholders alike can gain from efficiency enhancing and cost-minimizing strategies that will ultimately*

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<sup>12</sup>Pre-filed Evidence, Tab 2, page 5

<sup>13</sup>Oral Hearing, Volume 5, page 7, lines 20-26

<sup>14</sup>Oral Hearing-Volume 5, page 64, lines 13-16

<sup>15</sup>RP-1999-0034, page 13

*yield lower rates with appropriate safeguards for service quality. Under PBR, the regulated utility will be responsible for making its investments based on business conditions and the objectives of its shareholder within the constraints of the price cap, and subject to service quality standards set by the Board.*

16. This difference was just recently confirmed in the October 2012 Report of the Board- Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach<sup>16</sup>:

*Going into PBR, distribution rates are set based on a cost of service review. Subsequently, rates are adjusted based on changes to the input price index and the productivity and stretch factors set by the Board. PBR decouples the price (the distribution rate) that a distributor charges for its service from its cost. This is deliberate and is designed to incent the behaviours described by the Board in 2000. This approach provides the opportunity for distributors to earn, and potentially exceed, the allowed rate of return on equity.*

17. As a result, it is not the objective of IRM to ensure that an electricity distributor's approved spending is fully funded. Indeed, under IRM there is no "approved spending" that is to be "funded" through rates. Similarly, as noted by THESL, the concept of ratebase is not applicable to applications made under IRM<sup>17</sup>.

18. VECC notes that the Board's IRM framework does include specific mechanisms (e.g. the ICM module, Z-factors, opportunities for early rebasing and formal off-ramps) for those distributors who are truly experiencing problems under IRM. However, true-up for the difference between the rebasing year's year-end and average rate base is not one of them.

19. During the both the interrogatory process<sup>18</sup> and the oral hearing<sup>19</sup>, THESL suggested that the Board had not explicitly dealt with this issue and it was seeking clarification. However, in its recent Renewed Regulatory Framework for Electricity Distributors Report<sup>20</sup>, the Board explicitly stated that under PBR:

*It is not necessary, nor would it be appropriate, for ratebase to be re-calibrated annually.*

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<sup>16</sup>Pages 10-11

<sup>17</sup>Energy Probe IR #4

<sup>18</sup>VECC IR #7 b)

<sup>19</sup>Oral Hearing, Volume 5, pages 7 and 80

<sup>20</sup>Page 11

20. Furthermore, in its recently released Decision regarding Enersource's 2013 rate application (EB-2012-0033) the Board stated<sup>21</sup>:

*The Board has been clear that rate base re-calibration is generally not part of a multi-year ratemaking framework. Distributors are expected to respond to the incentives in the framework and the result will determine the returns shareholders earn.*

21. Overall VECC submits that, contrary to the view put forward by THESL, this is not area where policy direction from the Board is lacking. The Board has "pronounced" on this issue, both in its recent Board policy documents and utility-specific decisions, and has made it clear that rate base true-ups such as that proposed by THESL are not part of the IRM framework.

22. As result, VECC submits that the Board should deny THESL's request for a rate rider to recognize the difference between the revenue requirement associated with THESL's 2011 year-end rate base versus its 2011 approved rate base.

#### **1.4 What is the consequence of this application on any future application by THESL for rates for 2013 and/or 2014?**

##### *THESL Application*

23. The current (updated) application by THESL generally addresses rates for 2012 and 2013. THESL has confirmed that, despite the new options provided under the Board's Renewed Regulatory Framework, it intends to file an IRM/ICM application for 2014 as indicated in its evidentiary update<sup>22</sup>.

##### *VECC Submissions*

24. VECC notes that the IRM-based distribution rate applications are fairly straight-forward and does not foresee Board approval of the phase 1 (i.e., 2012 and 2013) portion of the Application as creating any issues/problems with THESL's IRM-based 2014 application.

25. VECC's submissions regarding consequences of approving the requested 2012-

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<sup>21</sup>Page 6

<sup>22</sup> AMPCO IR#3 and Oral Hearing, Volume 5, page 83



2013 ICM adders on THESL's future 2014 ICM application are dealt with under Issue 2.3.

## **ISSUE 2 Incremental Capital Module (“ICM”)**

### **2.1 Is THESL's application of the ICM criteria appropriate?**

26. There are a number of sub-issues related to THESL's interpretation and general application of the ICM criteria. These are identified and dealt with separately in the following sub-sections.

#### *Purpose of ICM – THESL's Application*

27. In both its pre-filed evidence and its responses during the interrogatory and oral phases of the current proceeding, THESL's has expressed the view that the “purpose” of the Incremental Capital Module (ICM) is to provide “funding” for revenue requirement associated with “eligible<sup>23</sup>” capital spending in excess of what cannot be funded through the IRM mechanism. Examples of evidence/testimony consistent with this view are:

- THESL's rationale for its suggested alternative to the standard ICM model predicated on the basis that –“This would allow for the regular capital-related revenue requirements for approved ICM spending, in excess of the level that can be supported through the growth- and PCI-adjusted level of depreciation”<sup>24</sup>.
- “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”.<sup>25</sup>
- Exhibit K4.3 wherein THESL has recast its ICM requirements in terms of revenue requirement unfunded by the standard IRM mechanism.
- “What Toronto Hydro is seeking is simply compensation for the assets that are in-service for customers and do represent a cost to put in place to Toronto Hydro”<sup>26</sup>.

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<sup>23</sup>The question of what is “eligible” is addressed later in these submissions

<sup>24</sup>Pre-filed Evidence, Tab 2, page 12

<sup>25</sup>Evidentiary Update, Tab 2 Addendum, page 1

<sup>26</sup>Oral Hearing, Volume 5, page 40

- “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”<sup>27</sup>.

#### *Purpose of ICM - VECC Submissions*

28. It is VECC's submission that the purpose of the ICM is not to fully fund eligible capital spending in excess of the level supported by the standard IRM mechanism. This perspective was put forward at the time the ICM was initially approved and was rejected by the Board<sup>28</sup>:

*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. (emphasis added). 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.*

29. As a result, in VECC's view, it is important to recognize that the ICM is an exception to the general framework of performance based ratemaking both within the conceptual model of PBR, and the specific requirements set out in the Board's 2008 report. The IRM model is designed to promote efficiency in utility performance,

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<sup>27</sup>Oral Hearing, Volume 5, page 69

<sup>28</sup>EB-2007-0673, Supplemental Report of the Board on 3<sup>rd</sup> Generation Incentive Regulation for Ontario's Electricity Distributors, page 31

certainty in ratemaking, and a streamlined regulatory process. Part of the design is to ensure that capital additions to rate base during an IRM period are made in much the same fashion as competitive business will authorize capital spending. That is, management will look to revenues from product sales and efficiencies to finance needed capital improvements. This perspective was recently confirmed in the Board's Decision regarding Enersource's EB-2012-0033 rate application<sup>29</sup>:

*Distributors are expected to respond to the incentives in the framework and the result will determine the returns shareholders earn. The Board therefore concurs with Energy Probe's submission: "Enersource already has the ability to compensate its shareholders for investments that are made every year during an IRM term. This ability is called productivity and efficiency improvements."*

30. Part of PBR's conceptual rationale is to prevent utilities from overcapitalizing rate base to increase their allowed profit that is based on a rate of return on the rate base (The Averch-Johnson effect). If capital can be added to rate base using the same criteria as may be applicable in a cost of service application, the intent of the IRM regime is subverted.

31. This latter method of proceeding was expressly disapproved in the EB 2011-0144, where the applicant herein attempted to obtain approval for substantial capital funding through an application for early rebasing. In coming to its conclusion, the Board noted on page 4 that :

*Where requests for early rebasing by electricity distributors are concerned, the test to depart from the Board's 3GIRM policy is articulated in the Board's letter of April 20, 2010 regarding Early Rebasing Applications, which stated:*

*A distributor, ..., that seeks to have its rates rebased in advance of its next regularly scheduled cost of service proceeding must justify, in its cost of service application, why an early rebasing is required notwithstanding that the "off ramp" conditions have not been met. Specifically, the distributor must clearly demonstrate why and how it cannot adequately manage its resources and financial needs during the remainder of its IRM plan period. Distributors are advised that the panel of the Board hearing the application may consider it appropriate to determine, as a preliminary issue, whether the application for rebasing is justified or whether the application as framed should be dismissed.*

32. The Board made clear in the above decision that there are not two regulatory

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<sup>29</sup>EB-2012-0033, page 6

framework models that are applicable, a cost of service model and an IRM model, there is only one multi-year setting plan that contains the road map as to how new capital expenditures may be added to rate base during the operation of an IRM period. This is the ICM whose requirements are understandably stringent for the purpose of the maintenance of the integrity of the PBR model.

33. The ICM recognizes the importance of the safe and uninterrupted operation of the distribution system and provides relief (but not necessarily fully compensates) for situations where electricity distributor's find that they are unable to undertake the non-discretionary work required to meet these objectives within the IRM framework. The key criteria that must be applied are materiality, need, and prudence. The application of the three criteria modifies the general term "non-discretionary" which gives it a meaning that is more limited than the simple take that the spending must be necessary for the operation of the distributor. While spending need not be unanticipated<sup>30</sup>, the application of the prudence factor makes clear that the timing and pace of capital expenditures must be considered notwithstanding the fact that the end result will be a distribution system improvement. There is an onus on the applicant to show that their ICM strictly fits within the requirements of the IRM rate-setting model and has not simply been brought forward to meet company desires that are outside the realm of operational necessity.

34. THESL claims that there has been an "evolution" in the Board's interpretation of the ICM since the 2007 Report<sup>31</sup>. VECC agrees that, throughout the various ICM-related decisions issued by the Board, there have been varying views as to the types of projects that qualify as being "eligible" for ICM treatment. However, VECC submits, there has been no change in the Board's perspective as to the fundamental difference between IRM versus Cost of Service based regulation. This is evident from the Board's recent Renewed Regulatory Framework Report<sup>32</sup>:

*The Board's rate-setting policy in this Report represents a further development of the approach adopted by the Board when it first established performance based*

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<sup>30</sup>Per the Board's most recent Filing Guidelines

<sup>31</sup>Oral Hearing, Volume 5, page 69

<sup>32</sup>Pages 10-11

regulation (“PBR”) for electricity distributors in its January 18, 2000 Decision with Reasons:

*... PBR is not just light-handed cost of service regulation. For the electricity distribution utilities in Ontario, PBR represents a fundamental shift from the historical cost of service regulation. It provides the utilities with incentive for behaviour which more closely resembles that of competitive, cost-minimizing, profit-maximizing companies. Customers and shareholders alike can gain from efficiency enhancing and cost-minimizing strategies that will ultimately yield lower rates with appropriate safeguards for service quality. Under PBR the regulated utility will be responsible for making its investments based on business conditions and the objectives of its shareholder within the constraints of the price cap, and subject to service quality standards set by the Board.”*

*Going into PBR, distribution rates are set based on a cost of service review. Subsequently, rates are adjusted based on changes to the input price index and the productivity and stretch factors set by the Board. PBR decouples the price (the distribution rate) that a distributor charges for its service from its cost. This is deliberate and is designed to incent the behaviours described by the Board in 2000.*

35. VECC also submits that there has been no change in the Board’s perspective as to the role of the ICM. Indeed, the Board’s recent Decision regarding THESL’s cost of service-based application for 2012 rates contained the following statement which reiterates the same quote from the Board’s Supplemental Report as referenced above<sup>33</sup>:

*The ICM was developed to address the circumstances of increased capital needs within 3GIRM. In its Report on 3GIRM, the Board set out the framework for the ICM and identified the eligibility criteria: materiality, need and prudence. In the Supplemental Report, the Board established the ICM materiality threshold and set out the associated filing guidelines and reporting requirements. In considering a distributor’s eligibility for the ICM, the Board stated:*

*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.*

36. VECC notes that, for those distributors seeking full funding for their future capital plans, the Board’s new Renewed Regulatory Framework offers the option of a

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<sup>33</sup>EB-2011-0144 Decision, page

Customer IR approach in lieu of the 4<sup>th</sup> Generation IR, where the former excludes but the latter includes the ICM<sup>34</sup>.

37. Overall VECC submits that mechanisms such as the ICM are meant to assist distributors in managing their spending within an IRM framework. However, they are not meant to negate the overall objective of IRM which is to create a regulatory environment that decouples rates for costs and expects/requires distributors to manage their business accordingly.

38. Since the normal operation of the IRM is not based on cost of service and rates are not based on funding requirements, VECC views this interpretation of the purpose of ICM as being fully consistent with the Board's statement in its Decision regarding THESL's EB-2011-0144 Decision<sup>35</sup> that:

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

#### *ICM Eligibility – THESL's Application*

39. In its Application<sup>36</sup> THESL has drawn on the Board's EB-2011-0144 Decision and set out the following as the eligibility criteria that projects must meet in order to qualify for the ICM.

- Discrete
- Material and Incremental
- Need (i.e. the projects are essential and non-discretionary)
- Prudent
- Unusual.

40. In its Argument-in-Chief<sup>37</sup>, THESL has noted that its Application had been prepared in accordance with the Board's June 2011 Filing Guidelines regarding IRM/ICM applications and that the more recent 2012 IRM/ICM guidelines exclude the

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<sup>34</sup>Pages 14-20

<sup>35</sup>Page 22

<sup>36</sup>Evidentiary Update, Tab 2, pages 14-21

<sup>37</sup>Page 9

requirement that the projects be unusual or unanticipated.

### *ICM Eligibility - VECC Submissions*

41. The eligibility criteria set out by THESL are generally in line with those set out in the EB-2007-0673 Supplemental Report of the Board<sup>38</sup> in that they relate to materiality, need and prudence and are also in line with the Board's Filing Guidelines<sup>39</sup> which require that the details be by project and, hence, the requirement for discrete projects. However, VECC has a number of issues with the way THESL has applied the eligibility criteria. Concerns regarding the interpretation/application of the Discrete, Need and Unusual criteria are discussed in the following paragraphs. The Non-Discretionary criterion, which includes a number of considerations, is discussed in the next section.

42. THESL's requested ICM portfolio consists of 10 projects, which can be further subdivided into 22 segments<sup>40</sup> and, then, further divided again into hundreds of jobs<sup>41</sup>. THESL claims that each of the 10 projects can be viewed as discrete. VECC does not agree. As discussed below, the eligibility criteria require that the need for each project should be directly related to the claimed cost driver which must be non-discretionary. This linkage to the "claimed cost driver" can only occur when the activities (i.e. jobs) included in an ICM project area all similar in terms of the work being done and the reason for the work being done. If the work is different, then there must, by definition, be a difference in the cost driver. In the ideal, each "job" should be viewed as a separate ICM project. Where there is a similarity in the jobs then it may be reasonable to combine similar jobs with the same driver into a common "segment". However to meet the discrete criterion (and enable a detailed calculation of the associated revenue requirement as discussed further below), it must be clearly defined when and where (i.e., what assets) each "job" will occur.

43. It is clear that not all the segments within each THESL project involve the same

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<sup>38</sup>Appendix B, page IV

<sup>39</sup> Filing Guidelines for 2012 Applications, Chapter 3, page 12

<sup>40</sup>Now 21 Segments since Grid Solutions was dropped in the Evidentiary Update

<sup>41</sup>Pre-filed evidence, Tab 2, pages 14-15

assets<sup>42</sup> and/or have the same cost driver<sup>43</sup>. VECC also notes that, contrary to the requirements the Board's Filing Guidelines<sup>44</sup>, THESL has not provided a detailed revenue requirement calculation for each the 22 (now 21) incremental capital segments and, indeed, not even for each of the 10 (now 9) projects. Instead the Incremental Capital Workform<sup>45</sup> provided simply provides an aggregate revenue requirement based on the total spending identified as being incremental to the ICM threshold.

44. This detail is essential to calculating the revenue requirement associated with the ICM capital, particularly should the Board adjust the amounts requested in any way. During the course of the oral proceeding THESL used a 10% capital recovery factor in order to estimate the impact of alternative ICM amounts. However, THESL acknowledged that this was "an approximation for simplicity"<sup>46</sup>. The Filing Guidelines call for a "detailed calculation" and in VECC's view this will require individual revenue requirement calculations for each ICM-eligible segment at a minimum.

45. In the case of the Need criteria, the EB-2007-0683 Supplemental Report of the Board sets out two requirements. First, that the "amounts should be directly related to the claimed driver, which must be clearly non-discretionary" and, second, that "the amounts must be clearly outside of the base upon which rates were derived"<sup>47</sup>. ICM claims have typically been based on projects that require one year. Within this context, non-discretionary has been taken to mean that the project must be undertaken in the year for which it is proposed. In THESL's case the initial application covered three years and, now, phase 1 covers only two (2012 and 2013). Within this context, VECC submits that non-discretionary means that that THESL needs to clearly demonstrate that all of the proposed jobs must be completed in the

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<sup>42</sup>An obvious example of this is the Underground Infrastructure and Cable Project, where one segment related to Handwells whereas another relates to Paper Insulated Lead Covered Cable.

<sup>43</sup>SEC IR #9

<sup>44</sup>Filing Guidelines for 2012 Applications, Chapter 3, page 12

<sup>45</sup>Sheet E3.1

<sup>46</sup>ExhibitK4.3 and Oral Proceeding, Volume 4, page 68

<sup>47</sup>Appendix B, page IV



two year window. If the projects do not meet this requirement then applications for supplemental ICM funding should await either the point in time when they can be demonstrated to meet the ICM criteria or the next rebasing application.

46. VECC's other concern is that, for some of THESL's segments, all of the jobs do not have the same "claimed driver" For example, in THESL's application there segments where the claimed non-discretionary driver is imminent reliability degradations. However, the segments include not only jobs based on this reliability driver but also jobs (or sub-activities with specific jobs) that are proposed simply on the basis of long-run cost minimization as opposed to reliability. In VECC's view these latter activities have a different driver and should have been included, for ICM assessment, as a separate project/segment and assessed for non-discretionary purposes on their own merits. The discussion under Issue 2.2 will identify those "segments" where this concern exists.

47. One major area of contention/interpretation is with respect to the requirement that the project be unusual and unanticipated. The view that ICM is intended to be reserved for "unusual circumstances" can be found in the EB-2007-0673 Report<sup>48</sup> of the Board and was subsequently incorporated into the annual Filing Guidelines up to (and including) those for 2012 Rate Applications. While the Supplemental Report did not specifically define "unusual", the Board's Decision regarding Hydro One's ICM Application for 2009 Rates did provide some insight:

*In considering Hydro One's application in this case it is apparent that Hydro One has conflated the calculation of the threshold and the eligibility criteria. While the relationship between depreciation expense and capital spending establishes the base materiality threshold, the relationship itself is not the determinative factor in assessing the appropriateness of the use of the incremental capital module. Hydro One has substantially predicated its application on the gap between its depreciation expense and its capital spending plan. In fact what the Board requires in considering an application under the incremental capital module is a demonstration that the distributor is facing extraordinary and unanticipated*

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<sup>48</sup> Page 31

*capital spending requirements; i.e. something other than the normal course of business. (emphasis added)*

48. However, as THESL has noted, the interpretation of what meets the eligibility criteria has varied with the Board's various Decisions and, in some cases, projects associated with critical rehabilitation work have been accepted for purposes of the ICM<sup>49</sup>. Furthermore, the requirement that the eligible projects be "unusual and unanticipated" has been dropped from the IRM Filing Requirements for 2013 rates<sup>50</sup>. These more recent Decisions appear to be the basis for the statement the Board in its EB-2011-0144 Decision<sup>51</sup> regarding THESL that "its thinking has evolved" when it comes to the types of projects that would qualify for ICM. This elimination of the "unanticipated" and "unusual" prerequisites was also noted in the Board's recent Renewed Regulatory Framework for Electricity Distributors Report<sup>52</sup>.

49. At the same time, the Board has made provision for a "Custom IR" application which, starting in 2014, would allow distributors to address exceptional capital spending requirements that were expected to continue for a number of years<sup>53</sup>. This would suggest that the ICM module associated with the 4<sup>th</sup> Generation IR option should be reserved for one-time events as opposed to being used to support on-going capital spending requirements or multi-year programs such as THESL has proposed. It is also worth noting that while the EB-2011-0144 Decision makes reference to the Board's thinking having "evolved"<sup>54</sup>, the same Decision specifically includes<sup>55</sup> the quote for the 2008 Supplemental Report of the Board that "the capital module is intended to be reserved for unusual circumstances that are not captured as a Z-factor" (emphasis added).

50. At the same time, it is worth noting that, to-date, all ICM approvals have been for very discrete projects. Even in the case of the rehabilitation work approved for

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<sup>49</sup> Oral Hearing, Volume 5, pages 90-91

<sup>50</sup> Argument-in-Chief, page 9

<sup>51</sup> Page 22

<sup>52</sup> Page 18

<sup>53</sup> Pages 18-19

<sup>54</sup> Page 22

<sup>55</sup> Page 21

Kingston, each vault rehabilitation was applied for and the need/non-discretionary cost drivers discussed separately<sup>56</sup>.

51. THESL's Application covers the years 2012-2014 and effectively bridges the period over which these various changes have purportedly been/will be occurring. If THESL's application was for the period 2014-2016, the Board would likely expect it to be framed as a Custom IR application and not an IRM/ICM application for multiple years. Similarly, if the Application had been filed for the 2010-2012 period, it would most likely have been found as not qualifying for ICM (as Hydro One's EB-2008-0187 application was).
52. In VECC's view, the Board has two options. One, given that THESL's application is for rates starting in 2012, it could apply the eligibility criteria as they were first framed in the Supplemental Report of the Board and set out in the June 2011 Filing Guidelines, including the requirement that eligible projects be "unusual and unanticipated". This is by far the simplest and cleanest interpretation of the eligibility criteria. However, as evidenced by the Board's EB-2008-0187 Decision regarding Hydro One, the ultimate findings of the Board may not be as simple to arrive at.
53. Second, the Board could apply eligibility criteria consistent with more recent decisions and the Board's Filing Guidelines for 2013 Rates, where the focus is more on the projects being essential and non-discretionary as opposed to unusual. However, given the multi-year nature of THESL's application, if such an approach is adopted by the Board, it should be made clear that the decision cannot be considered a precedent for future IRM/ICM applications where distributors also have the option of applying for a Custom IR if that is more appropriate to their circumstances.
54. Also, assuming the Board is still committed to the underlying objectives of IRM (i.e. decouple price from the cost of service and incent efficiency), it is important to ensure that the ICM does not become a basis by which distributors can true up their rate base (even subject to the 20% dead band incorporated in the ICM threshold).

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<sup>56</sup> EB-2011-0178, pages 17-19

To do so, there must be some features of the ICM eligibility criteria that clearly distinguish it from cost of service. However, decision regarding cost of service applications also uses criteria such as prudence and non-discretionary to determine what activities and related costs are to be included in the approved rate base and revenue requirement.

55. VECC submits that, if the requirement that an ICM project be “unusual and/or unanticipated” is eliminated, then the distinctions between the two become less evident and the integrity of the PBR model could be compromised. The Board has not introduced any new ICM criteria as part of its Renewed Regulatory Framework, but it has reaffirmed that “the requirement that the proposed expenditures be non-discretionary remains”<sup>57</sup>. Consistent with this reaffirmation, VECC submits that one way to try and ensure there is a distinction is to stringently apply the “non-discretionary” criterion when considering ICM applications, particularly ones that involve projects that are not “unanticipated or unusual”.

#### *Non-Discretionary – THESL Application*

56. In its Application THESL contends that projects should be considered as essential and non-discretionary if they meet one or more of the following drivers<sup>58</sup>:

- (a) Statute, code, provincial policy, or equivalent external requirement (including connection of customers, restoration of power, and externally initiated plant relocations);*
- (b) Considerations of safety for the public and for workers operating in, on, or around equipment;*
- (c) Existing or imminent reliability degradations;*
- (d) Existing or imminent capacity shortages;*
- (e) A material increase in cost (beyond the time value of money), if the project is necessary but undertaken at a later time.*

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<sup>57</sup>Page 18

<sup>58</sup> Pre-filed Evidence, Tab 2, page 17

57. Subsequently, in its interrogatory responses<sup>59</sup>, THESL provided a chart setting out which “drivers” applied to each Segment.

*Non-Discretionary - VECC Submissions*

58. With the exception of item (e). VECC generally agrees with drivers that THESL has indicated are the ones that should be used to establish whether or not a project is non-discretionary. However, VECC also believes that additional clarification is required for a number of them.

59. With respect to public and worker safety, THESL has acknowledged that that there “will always be risk associated with high-voltage or medium voltage distribution”<sup>60</sup>. As a result, for an ICM project to qualify as non-discretionary on the basis of “safety” it should be either a) responding to a new/emerging concern that the utility was not aware of at the time of its last rebasing application or b) reflecting continued work on a “safety issue” that was identified has been previous identified and for which funds had been (OEB) approved. In either case, consistent with VECC’s earlier submissions about ensuring a stringent application of the non-discretionary criteria, it must be clearly demonstrated that that there is a need to address the “risk” within the period covered by the ICM application (now two years in THESL’s case).

60. If a safety issue had been known to exist at the time of a distributor’s last rebasing and was not considered to be serious enough to address at that time, VECC submits that the utility should have to demonstrate a material change in circumstances in order for it to qualify as “non-discretionary” in an IRM/ICM application. Similarly, the non-discretionary attributes of the spending would need to be closely questioned, if project was identified in the previous rebasing application, but the IRM/ICM application is calling for a material increase in the level of required activity/spending. Again, in either case, the non-discretionary criteria should be stringently applied and ensure that there is a need to address the risk with the period covered by the ICM.

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<sup>59</sup>SEC IR #9

<sup>60</sup>Oral Hearing, Volume 4, page 57

61. In the case of reliability, VECC submits that a similar perspective should apply and for an ICM project to be considered as non-discretionary it should be either a) responding to a new/emerging concern regarding reliability degradation that the utility was not aware of at the time of its last rebasing or b) reflecting continued work on a project addressing an existing or imminent reliability degradation concern that was previously identified and for which funds have been (OEB) approved.

62. In the case of THESL where many of the safety and reliability driven projects involve multiple jobs over a number years the question of need within the ICM period become particularly important and a critical question is whether the proposed “pace” at which the projects is being undertaken (e.g. number of jobs per year) is essential and non-discretionary. Clearly this will depend on the nature of the issue being addressed. Ideally, where the project is addressing a situation that has not just recently arisen VECC submits that historical spending levels/pace of work could be used as a “cap” on the level of that can be considered non-discretionary spending. The logic of this is that, absent a change in circumstances, future non-discretionary spending should, by definition, be equal to and more likely less than the level of spending the distributor has chosen to commit in the past to addressing the particular reliability or safety matter. However, THESL has only been able to provide very “high level” information on the historical spending for its proposed ICM Segments<sup>61</sup>.

63. In the cases where the non-discretionary claim is based on a code/statute, there must again be a clear demonstration that the work needs to be done in the period covered by the ICM. If not, then VECC submits that the project is not non-discretionary. A similar requirement exists in those cases where the basis for the project being non-discretionary is a claimed capacity shortfall.

64. For THESL, considerations of cost effectiveness involve both whether the proposed approach/alternative being undertaken is the correct one and whether the timing (i.e. do it now) is optimal. In order to assist in assessing these issues THESL has

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<sup>61</sup>Capital Program Comparison, January 4, 2013

developed the Feeder Investment Model (FIM)<sup>62</sup>. First, VECC agrees that analysis such as that represented by THESL's FIM is the appropriate way to approach the assessment of cost effectiveness and associated prudence of proposed projects and supports THESL's use of such approaches in this context<sup>63</sup>. However, VECC notes that there are a number of limitations and simplifying assumptions used in the FIM which have been extensively documented by other parties to this proceeding (Board Staff, AMPCO and Energy Probe). As a result, VECC submits that it is important, when assessing the prudence of a proposed project to look at the sensitivity of the FIM results to reasonable changes in the input assumptions and, even then, to not overly rely on the analysis.

65. In its initial Application<sup>64</sup> and some interrogatory responses<sup>65</sup> THESL indicated that cost-effectiveness was also viewed as one of the drivers/justifications for a project being non-discretionary. However, elsewhere in the evidence THESL appears to contradict this position<sup>66</sup>: Board Staff counsel's attempts to clarify this issue during the course of the oral proceeding were unsuccessful<sup>67</sup>.

66. VECC has serious reservations about using "cost-effectiveness", particularly from a long-run cost perspective, as a driver for justifying that a project is non-discretionary and must be done with in the context of an ICM which is focused very much on the near term and whether there should be a compelling non-discretionary driver dictating that the project needs to be completed now. While projects maybe cost effective on the basis that they result in lower costs to customers over the long term, customers are also concerned about year over year bill impacts. Also, the future is uncertain and circumstances (particularly in the long run) may change. Further complicating this matter is the fact that cost effectiveness and efficiency are two attributes that IRM is seeking to incent, not provide additional compensation for.

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<sup>62</sup>Oral Hearing Volume 1, pages 24-25 & 46 and VECC IR 109 a)

<sup>63</sup>Oral Hearing Volume 1, page 131, lines 23-24

<sup>64</sup>Pre-filed Evidence, Tab 2, page 17 and Staff IR #19

<sup>65</sup>VECC IR #90 c) and VECC #109 b)

<sup>66</sup>VECC IR #22 b) and VECC IR #47 a)

<sup>67</sup>Oral Proceeding, Volume 2, page 46 and Volume 3, page 28

67. VECC notes that there are three specific projects (excluding Bremner) where “material increase in costs” is identified as one of the basis for “non-discretionary need”. In each case, there is at least one other claimed driver<sup>68</sup>. As a result, in THESL’s current application, “cost-effectiveness” has not relied been on to justify need any project in its entirety. However, within these three specific projects it has been used to include certain specific activities and certain specific jobs. These specific instances will be discussed further under Issue 2.2.

*ICM: Capital Spending vs. In-Service Additions – THESL Application*

68. During the course of the proceeding an issue emerged as to whether the calculation of the ICM threshold and the resulting ICM rate riders from any eligible amounts in excess of the threshold should be based on capital spending or capital in-service additions.

69. THESL application was prepared based on the “capital spending model” and, in its Argument-in-Chief, THESL explained that this reflected its reading of the Board’s various reports related to 3GIRM and ICM along with the requirements for completing the Board’s Incremental Capital Workform<sup>69</sup>.

70. In its Argument-in-Chief, THESL does not reject the “in-service additions” model but rather points out that the adoption of such an approach would need to be applied on a consistent basis and that changes in net fixed assets (i.e., in-service additions) would need to consider not only those resulting from capital spending in that year but also account for in-service additions arising due to construction work in progress from earlier years<sup>70</sup>.

*ICM: Capital Spending vs. In-Service Additions – VECC Submissions*

71. VECC acknowledges that the documentation of the ICM uses the term “capital expenditures” and not “in-service additions”. However, there is considerable

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<sup>68</sup>SEC IR #9

<sup>69</sup> Technical Conference, November 23 2012, page 131 and Argument-in-Chief, pages 5-7

<sup>70</sup>Argument-in-Chief, pages 11-13



evidence to support the position that both the ICM threshold value and the resulting rate riders should be determined based on in-service additions and that the references to “capital expenditures” are the result of a misuse of the term. In the case of the ICM threshold value this includes:

- The submissions by LPMA<sup>71</sup> during EB-2007-0673 which were the basis for the ICM threshold adopted by the Board<sup>72</sup>. LPMA’s presentation uses the term Capital Expenditures in explaining its proposed threshold formula. However, it is clear from the formulation (extracted below) that Capital Expenditures were meant to represent the in-service additions because additions to rate base can only be made when the assets are in-service.

$$(1) RB_p = RB_x(l+P)^x(l+G)$$

$$(2) RB_R = RB - DEP + CAPEX$$

*THE LEVEL OF CAPEX THAT RESULTS IN RATE BASE OF RB<sub>p</sub> CAN BE DETERMINED BY SETTING (2) EQUAL TO (1):*

$$(3) RB_R = RB_p \quad (3A) RB - DEP + CAPEX = RB_x(l+P)^x(l+G) \quad (3B) RB -$$

$$DEP + CAPEX = RB_x(l+P+G+(PxG)) \quad (3C) CAPEX = DEP + RB_x(P + G+(PxG))$$

*(3D) CAPEX = DEP + RB\_x(G+Px(1+G)) THIS EQUATION SHOWS THE LEVEL OF CAPEX THAT IS ACHIEVABLE*

*UNDER A PRICE CAP OF P% AND LOAD GROWTH OF G%*

*THIS CAN BE WRITTEN AS A CAPEX TO DEPRECIATION RATIO:*

$$(4) CAPEX/DEP = 1 + (RB/DEP)_x(G+Px(l+G))$$

*THIS RATIO COULD BE USED AS THE MATERIALITY THRESHOLD OR AS A BASE FROM WHICH THE THRESHOLD WOULD BE CALCULATED*

*VALUES FOR DEP, RB AND G WOULD BE TAKEN FROM THE BOARD APPROVED BASE YEAR RATE DECISIONS*

- Similarly, THESL, when describing the implications of the average annual versus year-end rate base for 2011, acknowledges the existence of CWIP but then uses Capital Expenditures instead of In-Service Additions in its calculation of the difference<sup>73</sup>.

<sup>71</sup> LMPA Presentation Submission, July 28, 2008

<sup>72</sup> EB-2007-0673 Supplemental Report of the Board, pages 32-33

<sup>73</sup> VECC IR #8

- Previously approved ICM amounts have been on the basis that the assets were coming into service in that year<sup>74</sup>. During the course of the oral proceeding there was some discussion regarding what Guelph Hydro had actually requested and been approved by the Board regarding the multi-year capital spending for a transformer station. Eventually it was confirmed that the 2009 and 2010 construction work in progress for the station was included in the 2011 ICM request – consistent with the “in-service additions” model<sup>75</sup>.
- THESL has acknowledged that there would be a “windfall” in favour of the utility if the ICM threshold and resulting rate riders are calculated based on capital expenditures<sup>76</sup>. However, VECC submits that the real problem is not the threshold formulation or the use of the ½ year rule, but rather the use of capital expenditures as opposed to in-service additions in the calculation of the ICM amounts in the first place.
- ICM capital spending is to be booked to the tracking account (Account 1508) when the assets go into service<sup>77</sup>. Such a requirement is consistent with the “in-service additions” model as opposed to a “capital expenditures” model.
- THESL’s consultant (Mr. Williams) used the “in-service additions” model in preparing Exhibit K4.3 and developing his recommendations to the Company to drop the request for the unrecognized 2011 closing net fixed assets<sup>78</sup>.

72. In the case of the determination of the ICM rate riders, supporting evidence for the use of the in-service additions model includes:

- THESL’s initial calculations (even prior to the filing of Exhibit K4.3 at the start of the oral proceeding) of the revenue requirement impacts of its proposal are based on an in-service additions approach as opposed to based on capital expenditures<sup>79</sup>.

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<sup>74</sup>Technical Conference, November 23, 2012, page 155

<sup>75</sup>Oral Hearing Volume 5, pages 48-52

<sup>76</sup>Pre-filed Evidence, Tab 2, page 12; Staff IR #79 and Technical Conference, November 23, 2012, page 158

<sup>77</sup>Oral Hearing Volume 5, page 121

<sup>78</sup>Oral Hearing Volume 4, pages 74-75

<sup>79</sup>For example, see Board Staff IR #17 b)

- THESL’s claims that what it is “seeking is simply compensation for the assets that are in-service for customers and do represent a cost to put in place to Toronto Hydro”<sup>80</sup>. Use of in-service additions as oppose to capital expenditures would be consistent with this objective.
- THESL proposes that the ICM true-up be based on an approach similar to that used by the Board for smart meters<sup>81</sup>. VECC notes that the smart meter rate rider and true up is based on an “in-service additions” model.
- The Board’s Filing Guidelines set out in the EB-2007-0673 Supplemental Report require that the ICM rider be based on the revenue requirement<sup>82</sup> associated with the eligible spending. Revenue requirement is based on assets in-service<sup>83</sup>.
- THESL acknowledges that differences between any revenues collected based on ICM rate riders calculated using capital spending and the actual revenue requirement attributable to when the assets are in-service will be addressed though the “true-up process”<sup>84</sup>. Clearly, the best way to avoid large variances would be to determine the ICM rides based on in-service additions as opposed to capital expenditures in the first place.

73. VECC submits that this issue has arisen from the fact that for most electricity distributors there is little to no difference between capital spending and in-service additions, i.e. capital is typically placed in-service the year it is spent. Hence the inter-changeable usage of the two terms. As a result, VECC does not particularly fault THESL for the approach it adopted. In VECC’s view this issue is one that clearly falls into the category of what THESL has characterized as “special issues” where clarification is required from the Board<sup>85</sup>.

74. In VECC’s view the appropriate approach would be to base both the ICM threshold calculation and the ICM rate rider calculation on the “in-service additions” model. While the Board’s Report and subsequent models referred to capital expenditures it

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<sup>80</sup>Oral Hearing, Volume 5, page 40

<sup>81</sup>Oral Hearing, Volume 5, page 20

<sup>82</sup> EB-2007-0673, Appendix B, page VI

<sup>83</sup>Oral Hearing, Volume 5, pages 36-37

<sup>84</sup>VECC IR #87 & 89 e; Energy Probe IR #53 a) & c) and CCC IR #22

<sup>85</sup>Oral Hearing Volume 5, pages 7-8

is clear from the references that VECC has provided above that the “in-service additions” approach is the one which is consistent with: a) how the ICM threshold was intended to be framed, b) how revenue requirements are determined in general and for rate riders, in particular, and c) minimizing any true up variance between forecasted and actual ICM-based revenue requirements during the IRM period.

75. THESL has indicated that if an “in-service additions” model is adopted then it would be necessary to take into account any consequential (i.e., subsequent years) impacts on in-service additions from the ICM projects and capital spending approved for a particular year<sup>86</sup>. VECC takes no issue with this approach provided the project spending has been approved as eligible for ICM treatment.

76. One final question that may arise under the “in-service additions” model is the treatment of the CWIP outstanding at the end of 2011 but that comes in-service during the IRM/ICM years. There are two aspects to this. First, should these in-service additions be included as non-discretionary 2012 and 2013 in-service additions<sup>87</sup> for purposes of establishing the maximum allowable ICM amounts for 2012 and 2013 (i.e. the amount by which non-discretionary in-service additions exceed the ICM threshold) and, second, whether these in-service additions themselves qualify for ICM treatment in 2012 and 2013 respectively.

77. In accordance with the Board’s Chapter 3 Filing Guidelines for both 2012<sup>88</sup> and 2013<sup>89</sup> rates, for spending to be included in the determination of the maximum allowable ICM amount it must be “non-discretionary”. In both cases the Guidelines specifically state: *“A distributor applying for recovery of incremental capital should calculate the maximum allowable capital amount by taking the difference between the 2012/2013 total non-discretionary capital expenditure and the materiality threshold”*.

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<sup>86</sup>Oral Hearing Volume 5, pages 40 & 58 and Argument-in-Chief, pages 12-13

<sup>87</sup>According to J5.5 the pre-2012 CWIP coming into service in 2012 and 2013 is \$67M and \$45.5M respectively.

<sup>88</sup>Chapter 3 Filing Guidelines for 2012 Rates, page 12

<sup>89</sup>Chapter 3 Filing Guidelines for 2013 Rates, page 8

78. THESL has identified what segments the CWIP at the end of 2011 and coming into service in either 2012 or 2013 is associated with<sup>90</sup>. The treatment of these amounts will be addressed under Issue 2.2 as part of the review of each project's eligibility.

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<sup>90</sup> Undertaking J5.1

**2.2 Has THESL provided sufficient evidence including consultant reports, business cases and consideration of alternatives, for the proposed capital projects to adequately justify them?**

79. The following table sets out THESL's total claimed non-discretionary capital spending and in-service additions for 2012 and 2013.

<b>THESL PROPOSED CAPITAL SPENDING AND IN-SERVICE ADDITIONS</b>					
(\$ Millions)					
		<b>2012</b>		<b>2013</b>	
		<b>Capital</b>	<b>In-Service</b>	<b>Capital</b>	<b>In-Service</b>
		<b>Spending</b>	<b>Additions</b>	<b>Spending</b>	<b>Additions</b>
B1 - Underground Infrastructure		28.75	15.62	58.94	66.94
B2 - PILC Piece Out & Leakers		0.08	0.04	5.42	3.35
B3 - Handwell Replacement		13.65	8.62	16.65	19.03
B4 - Overhead Infrastructure		9.07	4.02	55.88	43.00
B5 - Box Constructions		0.58	0.26	23.04	14.34
B6 - Rear Lot Construction		16.36	11.70	29.43	27.02
B7 - Polymer SMD-20 Switches		-	-	1.53	0.93
B8 - SCADA-Mate R1 Switches		-	-	1.43	0.87
B9 - Network Vault and Roofs		2.84	1.26	18.76	13.00
B10 - Fibretop Network Units		1.48	0.65	7.71	5.85
B11 - ATS & RPB		-	-	3.26	1.99
B12 - Station Transformers		0.38	0.17	3.48	2.33
B13 - Station Switchgear		1.73	0.77	21.81	18.91
B14 - Stations Circuit Breakers		0.76	0.62	0.55	0.76
B15 - Stations Control & Communications Systems		0.14	0.06	1.00	0.69
B16 - Downtown Station Load Transfers		0.68	0.30	2.14	2.34
B17 - Bremner TS		8.50	-	81.00	-
B18 - Hydro One Contributions		22.98	3.69	48.12	18.42
B19 - Feeder Automation		2.30	1.02	20.66	13.86
B20 - Metering		4.74	2.59	8.40	10.35
B21 - Externally-initiated Plant Relocations/Expansions		10.16	6.97	24.84	22.07
BXXX - Understated Capitalized Labour		8.32	3.69	-	4.63
C1 - Operations Portfolio Capital		120.51	94.47	121.63	151.88
C2 - IT Capital		22.00	19.12	15.00	21.47
C3 - Fleet Capital		0.80	0.63	2.00	0.76
C4 - Buildings and Facilities		5.00	6.90	5.00	2.89
AFUDC (re C1-C4)		1.20	0.15	1.40	2.14
<b>Total</b>		<b>283.00</b>	<b>183.30</b>	<b>579.09</b>	<b>469.81</b>
Source:	Exhibit J5.1				
	Shaded Amounts include pre-2012 CWIP				

### *Underground Infrastructure (B1) – THESL Application*

80. This segment includes 27 discrete jobs for 2012 and 2013. It is focusing on replacing direct buried cable with cable in concrete ducts and air-insulated switchgear units with SF6-insulated pad-mounted units<sup>91</sup>. The direct buried cable is past its useful service life and failing at a higher than anticipated rate. The air-insulated pad mount switchgear units have also been failing at an accelerated rate<sup>92</sup>. However, the program also involves the replacement of non-standard submersible transformers with new submersible transformers. For these assets it is not the submersible transformers themselves that are unreliable but rather the associated multi taps that are installed over the transformer<sup>93</sup>. THESL's rationale for replacing both is the claim that it is prudent (i.e., cost effective over the long-term) to do so<sup>94</sup>.

### *Underground Infrastructure (B1) – VECC Submissions*

81. This is a clear example of where THESL has included activities with different non-discretionary cost drivers in the same segment. THESL has directly linked the need for the replacement of the direct buried cable and the air-insulated switchgear to concerns over reliability and the potential for reliability degradation if the individual jobs are not undertaken. As part of its Application THESL has provided evidence regarding not only the poor health/condition of these assets but also their increasing failure rates<sup>95</sup>. The Application also explored various options for each addressing these concerns<sup>96</sup>. Overall, THESL has reasonably demonstrated that the replacement of these assets is non-discretionary and must be addressed at some point in the near future.

82. However, the same cannot be said for the replacement of the submersible transformers. Indeed, as noted above, during the course of the proceeding parties requested additional information regarding the reliability of the submersible

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<sup>91</sup>Evidentiary Update, Tab 4, Schedule B1, pages 1 - 2

<sup>92</sup>Evidentiary Update, Tab 4, Schedule B1, page 4

<sup>93</sup> Oral Hearing, Volume 3, pages 14-15 and Exhibit K3.1

<sup>94</sup>Oral Hearing, Volume 3, pages 20-21

<sup>95</sup>Pre-filed Evidence, Tab 4, Schedule B1, pages 110 - 125

<sup>96</sup>Pre-filed Evidence, Tab 4, Schedule B1, pages 126 - 140

transformers<sup>97</sup>. No real evidence, other than the health index, has really been provided regarding the reliability of these transformers. Furthermore, it was not until the oral proceeding<sup>98</sup> that it became clear that it was not the transformers themselves but the associated multi taps that THESL considered to be the real problem.

83. THESL has provided no information regarding the reliability of multi-taps other than their impact on the Health Index of the submersible transformers<sup>99</sup>. But it appears that Health Indexes are not necessarily a good predictor of failure rates<sup>100</sup>. As a result, VECC submits that THESL has failed to provide sufficient information to support the non-discretionary need claim for the multi taps and hence their proposed replacement of the submersible transformers.

84. Even if the Board decides to accept the need for the replacement of the multi taps based on reliability considerations, THESL has provided no real analysis of the individual jobs supporting the claim that the replacement of the entire submersible transformer is more cost-effective than just replacing the multi tap<sup>101</sup>. VECC submits that this lack of formal justification coupled with the previously discussed concerns about using cost-effectiveness as a criteria for a project at all should lead the Board to conclude that the replacement of the submersible transformers cannot be viewed as being non-discretionary even if the multi taps are.

85. Board Staff's Submissions<sup>102</sup> have included analysis as to the cost savings associated with not replacing the submersible transformers at all (\$6.6 M) or just replacing the multi taps (\$3.7 M, i.e., \$51.9 M less \$48.2 M). However, VECC notes that these amounts are based on the 2013 in-service additions associated with the 2012 and 2013 capital spending for Segment B1. For 2013, there is an additional

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<sup>97</sup>OEB Staff #30

<sup>98</sup>Oral Hearing, Volume 3, pages 13-15

<sup>99</sup>Exhibit K3.1

<sup>100</sup>Energy Probe IR #18

<sup>101</sup>At best, what has been provided is Exhibit K5.1 which compares the cost of the absolute cost of two activities with no associated consideration of when the submersible transformer would have to be replaced if left to a later date and the time value of money.

<sup>102</sup>Pages 16-18



\$15.06 M in planned in-service additions from the pre-2012 CWIP<sup>103</sup>. If one applies the same percentage reductions to this amount, total elimination<sup>104</sup> of the replacement of submersible transformers as being non-discretionary would reduce 2013 in-service additions by a further \$1.9 M<sup>105</sup>. Similarly, if the Board were to determine that the replacement of the multi taps can be considered non-discretionary then the reductions to the total 2013 in-service additions associated with the pre-2012 CWIP would be \$1.1 M.

86. Adding in these amounts would bring the total reduction in Segment B1 2013 in-service additions to \$8.5 M if the replacement of the submersible transformers is viewed as being discretionary and \$4.8 M if the Board decides that the replacement of the multi tap changers is non-discretionary.

87. Board Staff's Submissions did not address the 2012 in-service additions for this segment of \$15.62 M<sup>106</sup>. VECC appreciates that the planned spending for 2012 has been incurred. However, the point of this exercise is not to determine what spending THESL should do but rather what spending is eligible for ICM treatment. On this basis, VECC submits that the same non-discretionary analysis applies and that if the Board determines that none of the spending related to submersible transformers is non-discretionary then the amounts for 2012 should be reduced by \$2.0 M using the same approach. If the multi tap replacement is considered non-discretionary then the reduction would be \$1.1 M.

88. VECC notes that Energy Probe's submissions also raise concerns regarding the alternative (i.e., concrete ducts) THESL has selected for purposes of replacing the direct buried cable (e.g., whether or not in its analysis it has considered other alternatives on a balanced basis and whether its cost/benefit analyses includes all

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<sup>103</sup>Exhibit J5-1

<sup>104</sup>This does not mean that the OEB is saying the work should not be done, just that it should not be considered as non-discretionary for purposes of the ICM recognizing that it is not the purpose of ICM to provide funding relief for all work not "funded" by the IRM

<sup>105</sup>Calculated at  $6.6/51.9 * 15.06$ .

<sup>106</sup>Exhibit J5.1

relevant costs). These submissions warrant the consideration of the Board as the cost savings appear to be substantial (i.e., more than 25%).

89. Finally, Vaccinates that while the replacement of the direct buried cable, the air-insulated switchgear units and the multi taps is something that must be done in the foreseeable future. There is no evidence that the pace of the work has to be as accelerated as what has been proposed by THESL in order to satisfactorily address the associated reliability concerns. As noted earlier THESL's use of its FIM analysis should be limited to demonstrating prudence, not need, and even for that purpose the results are suspect.

90. VECC is not proposing any additional specific reductions to this Segment's spending based on this consideration. However, after its review of the individual segments VECC will be making comments on overall spending reductions that the Board should consider imposing.

#### *PILC Cable – Piece Outs and Leakers (B2) – THESL Application*

91. This project consists of 10 discrete jobs for 2012 and 2013<sup>107</sup>. Each job focuses on repairing and replacing Paper Insulated Lead Covered (PILC) primary cable at a particular section of feeder. The jobs have been established based on known defective and deficient cable situations<sup>108</sup>. The project is considered non-discretionary based on both work safety and reliability considerations<sup>109</sup>.

#### *PILC Cable – Piece Outs and Leakers (B2) – VECC Submissions*

92. VECC notes that the issues with PILC Cable have been known for over 20 years<sup>110</sup> and that prior to 2012 the capital spending to address this issue was less than \$1 M annually<sup>111</sup>. VECC does not question that these repairs and replacements need to be done. However, other than the observation that the backlog of known

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<sup>107</sup>Evidentiary Update, Tab 4, Schedule B2, page 1

<sup>108</sup>Pre-filed Evidence, Tab 4, Schedule B2, page 2

<sup>109</sup>SEC IR #9

<sup>110</sup>Pre-filed Evidence, Tab 4, Schedule B2, page 1, lines 15-16

<sup>111</sup>VECC IR #37 b)

defects/deficiencies has grown<sup>112</sup> there is no evidence as to why the average annual capital spending must now be two to three times higher in total over the 2012-2013 period.

93. VECC submits that there is clearly some discretion as to the pace at which this segment proceeds. Evidence of this is seen not only in the historic spending levels but in the fact that capital spending for 2012 was reduced for an originally planned amount<sup>113</sup> of \$17.32 M to \$0.08 M<sup>114</sup>. As a result, this is another area of potential focus in any considerations regarding the pacing of the overall planned spending.

#### *Handwell Replacement (B3) – THESL Application*

94. This is the continuation of a program that was initiated in 2009 after incidents occurred involving the public receiving shocks from energized equipment<sup>115</sup>. The objective is to replace existing handwells with new handwells built to current standards<sup>116</sup>. There are approximately 11,700 handwells on the system and, by 2011, almost 5,600 had been replaced. The purpose of this segment is to address the balance of the handwells by the end of 2014 except for those in areas where City moratoriums prevent the excavation of sidewalks or other pavement<sup>117</sup>.

#### *Handwell Replacement (B3) – VECC Submissions*

95. VECC notes of Energy Probe's submissions regarding the threshold voltage at which there is considered to be a safety issue and the fact that, in the majority of cases, this threshold voltage is not met. As a result, VECC agrees with Energy Probe's submissions that the majority of the work (at least 50%) cannot be viewed as non-discretionary for purposes of the ICM. Applying the 50% factor would reduce the eligible in-service additions for 2012 and 2013 by \$4.3 M and \$9.5 M respectively.

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<sup>112</sup>Pre-filed Evidence, Tab 4, Schedule B2, page 5

<sup>113</sup>Pre-filed Evidence, Tab 4, Schedule A, Appendix 1

<sup>114</sup>Exhibit J5.1

<sup>115</sup>Pre-filed Evidence, Tab 4, Schedule B3, page 1

<sup>116</sup>Pre-filed Evidence, Tab 4, Schedule B3, page 4

<sup>117</sup>VECC IR #41

*Overhead Infrastructure (B4) – THESL Application*

96. The purpose of this segment is to address issues associated with THESL's overhead infrastructure, including poles, transformers, conductors, switches and porcelain hardware<sup>118</sup>. THESL claims the work is non-discretionary in that it addresses safety and reliability issues<sup>119</sup>.

*Overhead Infrastructure (B4) – VECC Submissions*

97. THESL relies on calculations of its Feeder Investment Model to demonstrate that the segment is prudent and that it should proceed in the 2012-2014 period. VECC agrees that there is some level of immediate (i.e. 2012-2013) non-discretionary spending associated with these assets based on considerations of reliability. This is demonstrated in part by the evolution of the wood pole Health Index<sup>120</sup>. However, THESL has acknowledged that its FIM and associated Avoided Risk Cost analysis does not demonstrate that the Overhead Infrastructure Segment is non-discretionary<sup>121</sup>. As a result, it is not immediately clear that the pace activity/spending proposed is necessary.

*Box Construction (B5) – THESL Application*

98. This is a proactive program that will convert the legacy 4 kV overhead construction used in the former City of Toronto to standard 13.8 kV overhead construction<sup>122</sup>. Based on the Evidentiary Update<sup>123</sup> it includes 15 jobs over the 2012-2013 period. Some of the targeted feeders are related to the planned decommissioning of various 4 kV stations whereas the conversion of others will facilitate the future decommissioning of additional stations. The other non-discretionary drivers for the project are identified as worker safety, loading/capacity and reliability<sup>124</sup>.

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<sup>118</sup>Pre-filed Evidence, Tab 4, Schedule B4, page 1

<sup>119</sup>Pre-filed Evidence, Tab 4, Schedule B4, pages 11 - 13

<sup>120</sup>VECC IR #42 and Oral Proceeding, Volume 2, page 67

<sup>121</sup>VECC IR #47 a)

<sup>122</sup>Pre-Filed Evidence, Tab 4, Schedule B5, page 1

<sup>123</sup>Evidentiary Update, Tab 4, Schedule B5, page 1

<sup>124</sup>AMPCO IR #34

### *Box Construction (B5) – VECC Submissions*

99. VECC submits that a number of the drivers THESL has raised do not really justify this project as non-discretionary such that it must be done in 2012-2013:

- In terms of worker safety, the Electrical Safety Utilities Rules that THESL references were first cited in 2004. However, the same limits of approach have existed for decades prior to that<sup>125</sup>. As result, it is not clear why the project should be escalated to a “must do” for 2012-2013.
- In terms of loading/capacity, THESL has acknowledged that this was not a major driver<sup>126</sup>. Indeed, no evidence was provide that there were imminent capacity/loading issues with these feeders.
- While reliability on 13.8 kV overhead has been demonstrated to be better than for 4 kV<sup>127</sup>, the reliability issues described in the evidence relate to the age and condition of the stations not the associated feeders<sup>128</sup>.

100. The only real non-discretionary driver appears to be when the associated station is decommissioned and conversion is made to 13.8 kV. Board Staff’s Submissions<sup>129</sup> address this requirement and VECC adopts the resulting conclusion that the spending considered non-discretionary should be roughly five-eighths of that proposed by THESL. This would result in reductions of \$0.22 M in 2012 and \$5.38 M in 2013 in terms of in-service additions.

### *Rear Lot Construction (B6) – THESL Application*

101. The rear lot construction segment focuses on moving distribution service currently located in backyards to the street. Safety, reliability and cost are the identified non-discretionary drivers<sup>130</sup>.

### *Rear Lot Construction (B6) – VECC Submissions*

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<sup>125</sup>VECC IR #52 a)

<sup>126</sup>Technical Conference, November 21, 2012, page 78

<sup>127</sup>Pre-filed Evidence, Tab 4, Schedule B5, page 14

<sup>128</sup>Pre-flied Evidence, Tab 4, Schedule B5, page 15

<sup>129</sup>Pages 19-20

<sup>130</sup>Evidentiary Update, Tab 4, Schedule B6, page 4

102. Energy Probe's submission includes extensive discussion regarding THESL's claims this segment is non-discretionary and concludes that there is no compelling case based on either safety or reliability to support moving rear lot distribution to the front lot underground as proposed. VECC has reviewed and adopts Energy Probe's submissions on these matters.

103. As noted previously, VECC does not support the use of cost-effectiveness as a basis for demonstrating a proposed ICM project is non-discretionary. In this particular case, this position is reinforced by the submissions of Energy Probe regarding the particular inadequacies in THESL's application of its FIM analysis to the various alternatives available.

104. Overall, VECC submits that THESL has not adequately justified that this Segment's spending is non-discretionary for purposes of the ICM and its inclusion in the ICM should not be approved.

*Polymer SMD-20 Switches (B7) – THESL Application*

105. The purpose of this program is to replace 5,226 SMD-20 switches which have recently been identified as being defective. The defective nature of the switches has been confirmed through testing by both THESL and the manufacturer. Also, other utilities have experienced similar problems<sup>131</sup>. As a result of the defect, the switches are subject to failure when operated which could impact both public and employee safety. THESL is in discussion with the manufacturer regarding compensation and has undertaken to return any amounts received as a revenue offset at the time of rebasing<sup>132</sup>.

*Polymer SMD-20 Switches (B7) – VECC Submissions*

106. VECC takes no issue with the eligibility of this project for the ICM. Indeed, in VECC's view, this is just the sort of unanticipated and unusual event the ICM was meant to address.

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<sup>131</sup>OEB Staff #41 d)

<sup>132</sup>Pre-filed Evidence, Tab 4, Schedule B7, pages 1-2

### *SCADA-Mate R1 Switches (B8) – THESL Application*

107. SCADA-Mate R1 switches have recently<sup>133</sup> been identified as a safety risk to THESL crews in that they have unexpectedly operated as closed during routine maintenance activities. Furthermore, there were conflicting readings with the SCADA indicators in the control room. This failure is attributable to moisture buildup which corrodes the internal components. As the defect is not externally visible or testable there is no way to determine which of the switches are defective. The replacements will incorporate a new design so as to remedy the flaw in the R1 switches<sup>134</sup>.

### *SCADA-Mate R1 Switches (B8) – VECC Submissions*

108. VECC takes no issue with the eligibility of this project for the ICM. In VECC's view, this is another example of the sort of unanticipated and unusual event the ICM was meant to address.

### *Network Vaults and Roofs (B9) – THESL Application*

109. Under this project, THESL proposes to eliminate the immediate structural vault deficiencies of 26 high risk vaults over 2012-2013. The targeted vaults have been classified as being in either "very poor" or "poor" condition. As such they are considered to pose an immediate safety concern to THESL workers and the public as well as a reliability concern<sup>135</sup>.

### *Network Vaults and Roofs (B9) – VECC Submissions*

110. VECC takes no issue with this project being classified as non-discretionary and included as incremental for purposes of the ICM.

### *Fibertop Network Units (B10) – THESL Application*

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<sup>133</sup>VECC IR #60 a)

<sup>134</sup>Pre-filed Evidence, Tab 4, Schedule B8, pages 1-3

<sup>135</sup>Evidentiary Update, Tab 4, Schedule B9, pages 1-2 and VECC IR #63 & AMPCO IR #13

111. The objective of this project is to replace 61 Fibertop Network Units over 2012-2013. These units have been identified as having a design flaw<sup>136</sup> which makes them susceptible to moisture and contamination which can lead to fire, creating both safety and reliability issues. The units for replacement have been prioritized based on condition data and location (i.e., those below street level are more susceptible to failure)<sup>137</sup>.

*Fibertop Network Units (B10) – VECC Submissions*

112. VECC takes no issue with this project being classified as non-discretionary and included as incremental for purposes of the ICM. This conclusion also applies to the \$0.34 M in 2013 in-service additions associated with the pre-2012 CWIP<sup>138</sup>.

*Automatic Transfer Switches & Reverse Power Breakers (B11) – THESL Application*

113. The objective of this segment is to replace 14 ATSS and 4 RPBs in 2012-2013<sup>139</sup>. The need for these replacements is based on the Asset Condition Assessment results and inspection data<sup>140</sup>.

*Automatic Transfer Switches & Reverse Power Breakers (B11) – VECC Submissions*

114. The Asset Condition Assessment results support the contention that there has recently been a significant deterioration in the condition of the ATS assets which will lead to increase failures and degradation in reliability<sup>141</sup>. Physical inspections of the RPB units indicate that they are in similar condition. VECC takes no issue with this segment as non-discretionary and included as incremental for purposes of the ICM.

*Stations Power Transformers (B12) – THESL Application*

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<sup>136</sup>AMPCO #33 b) and Oral Hearing, Volume 4, page 7

<sup>137</sup>Evidentiary Update, Tab 4, Schedule B10, pages 1-3

<sup>138</sup>Exhibit J5.1

<sup>139</sup>Evidentiary Update, Tab 4, Schedule 11, page 1

<sup>140</sup>Pre-filed Evidence, Tab 4, Schedule 11, page

<sup>141</sup>Pre-filed Evidence, Tab 4, Schedule B11, pages 9-10 and Energy Probe IR #47 & OEB Staff #44 a)



115. This segment consists of replacing 10 power transformers at municipal stations over 2012-2013. THESL indicates that it has based the selection of the transformers on age, transformer leakage or condition assessment<sup>142</sup>.

*Station Power Transformers (B12) – VECC Submissions*

116. VECC has reviewed the submissions of Board Staff<sup>143</sup> and agrees with the analysis presented. However, VECC notes that as a result of THESL's evidentiary update, two of the five stations noted as being in Fair condition are not included in the 2012-2013 period<sup>144</sup>. The result is that eliminating the remaining three Transformers with a Fair Health Index reduces the capital expenditures for ICM for 2012 and 2013 by \$0.29 M and \$0.64 M respectively<sup>145</sup>. Based on the relationship between capital spending and in-service additions shown for this segment in Exhibit K5.1, it is estimated that this would reduce in-service additions for 2012 and 2013 by \$0.13 M and \$0.53 M respectively.

*Municipal Substation Switchgear Replacement (B13.1) – THESL Application*

117. The purpose of this segment is to replace the switchgear at a number of Municipal Stations. In all but one of the cases the switchgear is more than 50 year old. The stations were selected based on age, equipment obsolescence and safety risks<sup>146</sup>.

*Municipal Substation Switchgear Replacement (B13.1) – VECC Submissions*

118. VECC notes that the last two incidents with Municipal Station Switchgear were in 2007 and 2009<sup>147</sup>. Furthermore, the number of switchgear failures is not increasing and only one switchgear was replaced over the 2009-2011 period<sup>148</sup>. Given there

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<sup>142</sup>Evidentiary Update, Tab 4, Schedule B12, pages 1-2

<sup>143</sup>Board Staff Submissions, pages 20-21

<sup>144</sup>Evidentiary Update, Tab 4, Schedule B12, pages 1-2. The Stations are Norseman TR1 and Underwriter TR1.

<sup>145</sup>Based on the I/S dates and cost for these three stations as shown in Updated Tab 4, Schedule B12, pages 1-2

<sup>146</sup>Evidentiary Update, Tab 4, Schedule 13.1, pages 1-4

<sup>147</sup>Pre-filed Evidence, Tab 4, Schedule 13.1, page 3

<sup>148</sup>AMPCO IR #24 c)

appears to be no increasing problem with Municipal Switchgear and THESL's response to the earlier problems has been to only replace one Switchgear, VECC seriously questions whether initiating the replacement of 10 over the 2012-2013 period<sup>149</sup> is necessary to the point of being non-discretionary. As a result, VECC supports the submissions by Board Staff<sup>150</sup> regarding the lack of support for the case that all the proposed Switchgears require immediate replacement. VECC also agrees that those four stations identified as having operational issues that could comprise safety could be classified as non-discretionary and considered incremental for ICM purposes.

119. In total these four stations involve \$1.39 M for jobs starting in 2012 and \$1.64 M in capital spending for jobs commencing in 2013. This compares with total THESL's proposed total spending on Segment 13.1 of \$11.40 M in 2012-2013<sup>151</sup>. Since details on in-service additions versus capital spending are only available for Segments 13.1 and 13.2 on a combined basis, overall observations regarding the impact on capital in-service additions will be offered following the discussion of Segment 13.2.

*Stations Switchgear: Transformer Stations (B13.2) – THESL Application*

120. This segment involves the replacement of switchgear at four transformer stations

*Stations Switchgear: Transformer Stations (B13.2) – VECC Submissions*

121. VECC notes that of the four proposed stations, two have Health Indexes in the Poor Range (31-50) and two have Health Indexes in the Fair Range (51-70)<sup>152</sup>. VECC also notes that following four failures in 2009 there has only been one failure annually in each subsequent year<sup>153</sup>.

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<sup>149</sup>Evidentiary Update, Tab 4, Schedule 13.1, Table 1

<sup>150</sup>Board Staff Submissions, pages 22-23

<sup>151</sup>Evidentiary Update, Tab 4, Schedule 13.1, pages 2-3

<sup>152</sup>AMPCO IR #25 f) and h). The Transformer Stations with the Poor rating are Strachan and Wiltshire

<sup>153</sup>AMPCO IR #24 d)

122. Based on these observations, VECC supports Board Staff's conclusions that all of the proposed replacements cannot be considered as absolutely necessary in 2012-2013 and therefore cannot be considered non-discretionary for purposes of the ICM. VECC does accept there may be a case for those stations with the Poor Health Index rating being considered non-discretionary. These stations (Strachan and Wiltshire) account for \$10.46 M of the total \$12.14 M capital spending over 2012-2013 for this segment and all of the 2012 spending<sup>154</sup>.
123. THESL's evidentiary update calls for a total of \$1.73 M and \$21.81 M in capital spending in 2012 and 2013 respectively for Segments 13.1 and 13.2 combined for an overall total of \$23.54 M<sup>155</sup>. Of this, \$0.77 comes in-service in 2012, \$14.24 comes into service in 2013 and \$8.54 comes into service after 2013.
124. Combining VECC's submissions for both Segments 13.1 and 13.2, the total capital spending amounts considered non-discretionary for purposes of the ICM are \$8.44M for 2012 initiated projects (\$1.39 M from 13.1 and \$7.05 M from 13.2) and \$5.05 M for 2013 (\$1.64 M from 13.1 and \$3.41M from 13.2) for a total of \$13.49 M. Using the in-service additions split from J5.1 this would translate into revised 2012 in-service additions of \$0.44 M and revised 2013 in-service additions of \$8.16 M with an outstanding CWIP post-2013 of \$4.89 M<sup>156</sup>.
125. Finally, Segments 13.1 and 13.2 have \$4.67 M in 2013 in-service additions associated with pre-2012 CWIP<sup>157</sup>. As no information is available on the nature of jobs this is associated with VECC submits that it should not be included in the in-service additions considered to be non-discretionary for ICM purposes.

#### *Station Circuit Breakers (B14) – THESL Application*

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<sup>154</sup>Evidentiary Update, Tab4, Schedule 13.2, Table 1

<sup>155</sup>Exhibit J5.1. Note - While the total spending is the same, these values do not appear to reconcile for each year (2012 and 2013) with the spending estimates set out in the Evidentiary Update, Tab 4, Schedule 13.1, Table 1 and Schedule 13.2, Table 1. The impact of VECC's submissions has been calculated so as to reconcile with Exhibit J5.1.

<sup>156</sup>For example:  $13.39/23.54*0.77+0.44$

<sup>157</sup>Exhibit J5.1

126. This segment consists of work in 2012 to replace nine oil circuit breakers and the associated control boxes at five Terminal Stations<sup>158</sup>. The rationale for the work is that the current circuit breakers are obsolete such that replacement parts are no longer being manufactured and, as a result, maintenance costs are rising and repair times are long<sup>159</sup>. Another driver is the collateral damage that can occur with a failure<sup>160</sup>.

#### *Station Circuit Breakers (B14) – VECC Submissions*

127. THESL has generally used age and condition as the factor in selling the circuit breakers<sup>161</sup>. However, VECC notes that the four of the nine breakers in the updated list those scheduled for replacement have a Health Index rating of Fair and none of the others have any rating at all.<sup>162</sup>

128. VECC also notes that while the overall avoided risk cost for the segment is positive<sup>163</sup>, there are several individual jobs (approximately 25% of the total) where the avoided risk cost is negative and the optimal intervention timing is well after 2015. Unfortunately the coding of the jobs listed in the related IR response differs from that used in the Application and one cannot determine if these particular jobs are still included in THESL's update for 2012-2013.

129. Based on these observations, VECC submits that it is unreasonable to consider the replacement of all nine circuit breakers as being non-discretionary in 2012-2013. In VECC's view no more than five breakers should be targeted for replacement within the ICM. Excluding those breakers with a Fair rating reduces the 2012-2013 capital spending by \$0.78 M (i.e. from \$1.31 M to \$0.53 M). Prorating this across the current forecast in-service additions, reduces the forecast 2012 in-service

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<sup>158</sup>Evidentiary Update, Tab 4, Schedule B14, page 1

<sup>159</sup>Evidentiary Update, Tab 4, Schedule B14, page 11

<sup>160</sup>Oral Hearing, Volume 4, page 27

<sup>161</sup>Evidentiary Update, page 3

<sup>162</sup>AMPCO IR #26. VECC IR #79 purports to list health indexes for those breakers being replaced but includes some that were dropped in the Update.

<sup>163</sup>VECC IR #80

additions from \$0.62 M<sup>164</sup> to \$0.26 M and the forecasted 2013 in-service additions from \$0.76 M to \$0.31 M.

*Station Control and Communication Systems (B15) – THESL Application*

130. The work in this segment consists of improving the SONET communication redundancy, upgrading SONET system communication capacity and installing SCADA RTUs<sup>165</sup>.

*Station Control and Communication Systems (B15) – VECC Submissions*

131. VECC notes that the proposed work can be broken down into two components. The first consists of the various jobs aimed at improving the redundancy of the SONET communications and the second focuses on the replacement of the communication system used in Etobicoke<sup>166</sup>. With respect to the SONET redundancy work, THESL explained that the “nature of the communications links evolves over time so our network has to evolve over time as well”<sup>167</sup>. THESL claimed that not to make the investments would erode reliability. However, at the same time the investments were characterized as improving restoration times<sup>168</sup>.

132. THESL has not identified any specific recent changes on the system that have led to the need for the SONET communications investments. Rather, it appears to VECC that these investments are a more general response to system growth and changes and represent the types of investments that a utility would undertake and manage overtime as its system evolves. Also, given the rather low level of spending on similar projects in the last five years (i.e., \$0.31 M in 2010 and \$0.13 M in 2012 or roughly \$90,000 per year)<sup>169</sup> this does not appear to have been an area of real concern to THESL up until the time of this Application. Based on this evidence,

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<sup>164</sup>This value includes the pre-2012 CWIP that will be in-service in 2012. For simplicity purposes it has been pro-rated using the same approach.

<sup>165</sup>Evidentiary Update, Tab 4, Schedule B15, page 1 and AMPCO IR #27 d)

<sup>166</sup>Pre-filed Evidence, Tab 4, Schedule 15, pages 16-17

<sup>167</sup>Oral Hearing, Volume 4, page 29 - 30.

<sup>168</sup>Oral Hearing, Volume 4, page 30, lines 7-11 and 17-19.

<sup>169</sup>Board Staff IR #52 b)

VECC submits that the SONET communications part of the segment should not be considered as non-discretionary for purposes of the ICM.

133. The second part of this segment involves replacing the communication system used in the Etobicoke area which has reached the end of its useful life and is obsolete<sup>170</sup>. VECC notes that despite the age of the equipment the number of entries in defective equipment tracking related to Etobicoke RTUs equipment and the MOSCAD System has generally declined over the past three years<sup>171</sup>. In VECC's view, this experience does not suggest that the system needs to be replaced now (i.e., 2012-2013) such that this work can be viewed as non-discretionary for purposes of the ICM.

134. In reality, the proposal to complete the work in this period appears to be based more on an interest in coordinating this work with planned station maintenance in 2012<sup>172</sup> than concerns about imminent failure. As a result, VECC submits that this work should not be considered as non-discretionary for purposes of ICM either.

*Downtown Station Load Transfers (B16) – THESL Application*

135. This segment includes the completion of the Dufferin-Bridgman feeder tie work that was largely completed in 2011 and two new jobs that are required to provide feeder ties between Basin and George and Duke stations, and Basin and Carlaw stations<sup>173</sup>.

*Downtown Station Load Transfers (B16) – VECC Submissions*

136. The objective of these projects is to create a redundancy where one currently does not (and never did) exist<sup>174</sup>. THESL claims that this project is addressing an imminent reliability degradation in that its system assets are aging, the risk of their

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<sup>170</sup>Pre-filed Evidence, Tab 4, Schedule B15, page 4

<sup>171</sup>AMPCO IR #27 b)

<sup>172</sup>Evidentiary Update, Tab 4, Schedule B15, page 10

<sup>173</sup>Evidentiary Update, Tab 4, Schedule B16, page 1

<sup>174</sup> Oral Hearing, Volume 4, page 14

failure is increasing over time and the proposed load transfer projects will give THESL increased flexibility to address this risk.

137. THESL indicates that its concern is specifically with the switchgear and breakers at its stations<sup>175</sup>. However, as noted by Board Staff<sup>176</sup>, the proposed spending only provides relief for a fraction of the loadings on the related stations. Furthermore, in its application, THESL is also seeking funds to address both of these areas (Segments B13 and B14) and VECC has agreed that some the spending requested in these areas should be considered non-discretionary for purposes of ICM. As a result, VECC submits that THESL is already directly addressing the problem of imminent reliability degradation as it relates to these concerns and the work associated with this segment (B16) should not be considered as non-discretionary for purposes of the ICM.

*Bremner TS (B17)*

138. The Bremner TS has been excluded from this phase of the proceeding.

*Hydro One Capital Contributions (B18) – THESL Application*

139. This segment captures the capital contributions that THESL is required<sup>177</sup> to make to Hydro One Networks Inc. for capital projects related to transmission service. It includes contributions for both engineering studies and capital works<sup>178</sup>.

*Hydro One Capital Contributions (B18) – VECC Submissions*

140. VECC takes no issue with the fact that capital contributions made to Hydro One Networks in accordance with the TSC should be considered as non-discretionary for purposes of the ICM. The key issue with the respect to such contribution payments is when they are recognized (i.e. the year the payment is made or the year the Hydro One capital project goes in-service). VECC submits that ICM consideration of

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<sup>175</sup>Pre-filed Evidence, Tab 4, Schedule B16, page 2, lines 9-11

<sup>176</sup>Board Staff Submissions, pages 23-24

<sup>177</sup>Under the Transmission System Code (TSC)

<sup>178</sup>Evidentiary Update, Tab 4, Schedule B18, page 1

such expenditures should be for the year in which the related Hydro One Networks assets are placed in-service. This is consistent with the “in-service” model that VECC supports for ICM treatment of THESL’s expenditures on its own assets. VECC notes that this is the same treatment that THESL affords to capital contributions it received from its customers<sup>179</sup>.

141. During the oral part of the proceeding THESL provided an undertaking<sup>180</sup> that listed the various Hydro One Networks projects for which it is making capital contributions and the expected completion date of each project. Similar to Board Staff, VECC has had some difficulty reconciling the project timing set out here and the associated spending documented in the application<sup>181</sup> with the both the capital spending and the in-service additions by year shown in Exhibit J5.1.

142. As well as the issue Board Staff has noted regarding the 2013 in-service additions<sup>182</sup>, VECC notes that the total capital expenditures related to capital contributions is different as between the Evidentiary Update (\$72.88 M) and Exhibit J5.1 (\$71.10 M). VECC supports Board Staff’s submission that, based on the evidence provided, the in-service capital additions for 2013 should be those related to the Malvern TS and the Leslie MS which total \$1.48 M as opposed to the \$10.7 M THESL has included in Exhibit J5.1.

143. VECC also notes that there are an additional \$7.72 M in pre-2012 capital contributions for assets forecast to be in-service in 2013<sup>183</sup>. As there is no evidence as to what these expenditures are related to and no additional projects (beyond Malvern and Leslie) reported as coming in-service in 2013, VECC submits that there is no basis on which to include these dollars as non-discretionary for purposes of the ICM.

### *Feeder Automation (B19) – THESL Application*

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<sup>179</sup>VECC IR #89 c)

<sup>180</sup>Exhibit J3.3

<sup>181</sup>Evidentiary Update, Tab 4, Schedule B18, Table 1 (pages 2-3)

<sup>182</sup>Board Staff Submissions, page 25

<sup>183</sup>Exhibit J5.1



144. This segment's work involves installing automatic switches, software and communications devices on selected trunk feeders. The feeders are selected based on both their reliability (e.g. number of outages) and with a view to connecting into the existing Feeder Automation implementation<sup>184</sup>.

#### *Feeder Automation (B19) – VECC Submissions*

145. THESL claims that the segment needs to proceed now in order to: a) reduce the current reliability impact of feeder trunk outages, b) reduce the risk of future outages due to the high probability of equipment failure, and c) to ensure effective FA saturation of the system<sup>185</sup>. When asked why the project was non-discretionary, THESL stated "it introduces a new technology into the system that will significantly reduce the impact of trunk related outages on targeted at risk feeders"<sup>186</sup>.

146. VECC has reviewed and agrees with Board Staff's submissions<sup>187</sup> regarding this segment that there is no evidence of imminent reliability degradation that would lead to implementing FA on the selected feeders to be considered non-discretionary for purposes of the ICM. VECC also notes (as does Board Staff) what appears to be an apparent overlap between this initiative and the Worst Performing Feeder initiative included under Operations Portfolio Capital (C1)<sup>188</sup>.

#### *Metering (B20) – THESL Application*

147. There are two components to this segment's work. The first relates to wholesale metering in the replacement of legacy meters in accordance with an IESO approved plan to complete full meter upgrades at all delivery points by 2021. This is necessary in order to remain in compliance with the Market Rules<sup>189</sup>. The second

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<sup>184</sup>Pre-filed Evidence, Tab 4, Schedule 19, pages 1-2

<sup>185</sup>Pre-filed Evidence, Tab 4, Schedule 19, page 3

<sup>186</sup>VECC IR #90 a)

<sup>187</sup>Pages 25-26

<sup>188</sup>Pre-filed Evidence, Tab 4, Schedule C1, page 3

<sup>189</sup>Pre-filed Evidence, Tab 4, Schedule B20, page 3

component relates to THESL's retail meters and involves replacing meters in compliance with Measurement Canada requirements<sup>190</sup>.

#### *Metering (B20) – VECC Submissions*

148. VECC takes no issue with this project being classified as non-discretionary and included as incremental for purposes of the ICM. This conclusion would also apply to the \$0.49 M in 2012 in-service additions and the \$2.6 M in 2013 in-service additions associated with the pre-2012 CWIP<sup>191</sup>.

#### *Plant Relocations (B21) – THESL Application*

149. THESL is obligated to relocate its infrastructure if requested to do so by the relevant Road Authority. This segment represents work that THESL must undertake to relocate facilities as a result of construction projects initiated by parties such the City of Toronto, MTO, Go Transit and Waterfront Toronto government and other agencies within the City of Toronto.

150. The proposed capital expenditures are based on proposed agency work during the period, a determination of the necessary THESL work and an apportioning of the costs on the basis of existing legislation and land use agreements<sup>192</sup>. However, THESL indicates that the segment can also include circumstances where externally driven construction projects provide an opportunity for THESL to expand its infrastructure in conjunction with a relocation project<sup>193</sup>. Such work is fully paid for by THESL<sup>194</sup>.

#### *Plant Relocations (B21) – VECC Submissions*

151. In the case of Waterfront Toronto-related jobs, the majority of the expenditures are related to expansion as opposed to relocation; whereas for the other Agencies'

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<sup>190</sup>Pre-filed Evidence, Tab 4, Schedule B20, page 4

<sup>191</sup>Exhibit J5.1

<sup>192</sup>OEB Staff IR #63 a)

<sup>193</sup>Pre-filed Evidence, Tab 4, Schedule B21, pages 1 and 7

<sup>194</sup>Oral Hearing, Volume4, page 52

jobs virtually all, if not all, of the spending is associated with relocation work<sup>195</sup>. Overall, out of the \$35 M in capital spending proposed for 2012-2013 almost half (\$17.2 M) is associated with expansion work for the Waterfront Toronto jobs<sup>196</sup>.

152. VECC notes that while this expenditure on expansion may be viewed as eventually needed from a long run planning perspective, there is no evidence that the anticipated growth<sup>197</sup> will lead to capacity issues in the near term. As a result, VECC submits that the work is not essential for 2012-2013 and, therefore, cannot be considered as non-discretionary for purposes of the ICM.

153. It is not precisely clear how this Waterfront Toronto-related spending impacts the reported in-service additions for this segment per Exhibit J5.1. For purposes of these submissions, VECC has assumed that the expenditures come into service in 2012, 2013 and subsequent years in the same proportional distribution as the overall spending for the segment. This results in reductions in the segment's in-service additions of \$2.2 M in 2012 and \$10.2 M in 2013, with the balance impacting future years' in-service additions.

#### *Grid Solutions (B22)*

154. This segment was not included in the Application's Evidentiary Update.

#### *Engineering Capital (BXXX) – THESL Application*

155. This "segment" is to correct for the fact that incorrect allocation factors were initially used in assigning engineering capital to Segments B1 through B22<sup>198</sup>.

#### *Engineering Capital (BXXX) – VECC Submissions*

156. VECC notes that the amounts included in the Application assume that all of the capital spending and associated in-service additions are approved for inclusion in

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<sup>195</sup>SEC IR #23 a)

<sup>196</sup>Determined based on the individual Waterfront Toronto job costs as shown in the Evidentiary Update, Tab 4, Schedule B21, Table 1 and the proportion of each job's cost related to expansion as shown in SEC IR #23 a).

<sup>197</sup>Oral Hearing, Volume 4, page 44, lines 26-27

<sup>198</sup>Exhibit JT2-10 and Oral Hearing, Volume 4, pages 95-96

the ICM. VECC also notes that in explaining the “correction” the THESL witness indicated twice that it was Engineering Capital associated with Segments B1 to B22<sup>199</sup>. However, Segment B22 (Grid Solutions) was dropped for purposes of the Evidentiary Update.

157. Clearly, if the capital in-service additions approved by the Board for ICM treatment are less than what THESL has requested then these amounts (\$3.69 M for 2012 and \$4.63 M for 2013) will have to be reduced accordingly. Also, subject to any clarification from THESL, these amounts will need to be reduced to reflect the fact that the Application does not include any spending for Grid Solutions.

#### *Operations Capital Portfolio (C1) – THESL Application*

158. THESL has characterized the work in this Segment (and the other “C” segments) as work below the ICM materiality threshold<sup>200</sup>. It is also characterized as work that was not put into the ICM business cases because it did not meet the ICM criteria<sup>201</sup>. At the same time THESL has indicated that all of the work, including that in the C segments and below the threshold needs to be done (i.e., it is non-discretionary)<sup>202</sup>.

159. The Operations Capital Portfolio is made up of five components<sup>203</sup>:

- Engineering Capital
- Worst Performing Feeder Capital
- Customer Connections Capital
- Reactive Capital
- Continuing Projects and Emerging Issues Portfolio Capital.

#### *Operations Capital Portfolio (C1) – VECC Submissions*

160. As part of an ICM Application a distributor is required to identify the extent to which its non-discretionary capital budget for the year exceeds the ICM threshold

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<sup>199</sup>Oral Hearing, Volume 4, page 96, line 11 and line 15.

<sup>200</sup>Oral Hearing, Volume 1, page 16

<sup>201</sup>Oral Hearing, Volume 1, page 45, lines 18-22

<sup>202</sup>Oral Hearing, Volume 1, page 44, lines 17-20

<sup>203</sup>Evidentiary Update, Tab 4, Schedule C1, page 1

value. This difference becomes the maximum amount of ICM capital that a distributor is eligible to be compensated for. The distributor is also required to identify the specific projects for which it is seeking approval to be considered eligible for ICM treatment. If the spending associated with the approved ICM projects exceeds the “difference” previously noted then the ICM rider is based on this difference. In the alternative, if the spending associated with the approved ICM projects is less than this difference, then the ICM rider is based on the spending associated with the approved ICM projects<sup>204</sup>.

161. Within this context, VECC understands THESL application to include the “C” Segments as part being part of its overall non-discretionary capital budget but to not be segments for which it is requesting ICM approval. The implications are that while there must be a demonstration that the spending is no-discretionary, there is no requirement for the details to be provided on a project by project basis.

162. Engineering Capital represents labour costs that are capitalized although they are not attributable to specific assets or projects. These costs are associated with the engineering, design and planning work that must be done to support the projects<sup>205</sup>. For those projects for which ICM treatment has been requested, Engineering Capital has been included as part of the projects’ costs. The Engineering Capital included in Segment C1 represents the “engineering” support required for the various capital projects included in Segments C1 to C4<sup>206</sup>.

163. VECC submits that this Engineering Capital can be considered as non-discretionary provided the various projects included in Segments C1 to C4 have been determined to be non-discretionary. Any reductions to these amounts for purposes of establishing the non-discretionary capital budget should result in a proportional reduction in the Engineering Capital considered to be non-discretionary.

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<sup>204</sup>Board’s Filing Guidelines for Electricity Transmission and Distribution Applications (June 2012), Chapter 3, pages 8-10

<sup>205</sup>Evidentiary Update, Tab 4, Schedule C1, page 2

<sup>206</sup>OEB Staff IR #67 a) & b)

164. The second component is Worst Performing Feeder (WPF) Capital. The WPF program involves identifying the system's worst performing feeders from a reliability perspective and then executing work to improve the feeders' performance<sup>207</sup>. VECC notes that that the WPF program annual spending for 2012 and 2013 is considerably less than that over the 2008-2011 period<sup>208</sup>. Given this fact and in the absence of the Feeder Automation program, which VECC earlier identified as being discretionary, VECC submits that the WPF Capital should be considered as non-discretionary spending within THESL's overall capital budget.
165. The third component is Customer Connections Capital. This spending relates to the connection of new customers and performing service upgrades requested by existing customers<sup>209</sup>. THESL has an obligation to connect and supply customers in accordance with its Conditions of Service. As a result, VECC accepts that this spending should also be considered as a non-discretionary portion of THESL's capital budget.
166. The fourth component is Reactive Capital. This is capital expenditures necessary to repair defective and failed equipment on a reactive basis<sup>210</sup>. VECC notes that between 2008 and 2011 the historical spending in this area has ranged between \$19.3 M and \$28.6 M<sup>211</sup>. In contrast, the budgeted spending is \$25.4 and \$29.3 M for 2012 and 2013 respectively<sup>212</sup>. VECC submits that it is reasonable to accept this level of Reactive Capital as non-discretionary budget spending.
167. The final component is Continuing Projects and Emerging Issues Portfolio Capital. THESL states that Emerging Projects addresses pressing issues that require intervention within a year, in contrast to Reactive Capital which deals with failed assets and assets that require immediate attention<sup>213</sup>. THESL acknowledges that that there is an overlap between the types of issues that will be dealt with under

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<sup>207</sup>Evidentiary Update, Tab 4, Schedule C1, page 3

<sup>208</sup>Capital Program Comparison (filed January 4, 2013), page 10

<sup>209</sup>Evidentiary Update, Tab 4, Schedule C1, page 5

<sup>210</sup>Evidentiary Update, Tab 4, Schedule C1, page 6

<sup>211</sup>VECC IR #105 a)

<sup>212</sup>Evidentiary Update, Tab 4, Schedule C1, page 6

<sup>213</sup>Evidentiary Update, Tab 4, Schedule C1, page 8

this initiative and the work associated with its ICM requests<sup>214</sup>. THESL has also indicated that in order to address “emerging issues” it may be necessary to rejig the work programs so as to free up materials that are at hand to do the work<sup>215</sup>. Based on this VECC submits that there is an obvious overlap and work impacts between this project and the project spending for Segments B1-B22 that THESL has already put forward as part of the overall budget and requested ICM treatment. To address this VECC submits it would be reasonable to reduce the budget in this area which is to considered as non-discretionary by 10%.

168. This would have the effect of reducing capital spending in 2012 and 2013 by \$5.6 M and \$4.0 M respectively<sup>216</sup>. There is insufficient information available to determine what the resulting impact on capital in-service additions would be. However assuming the same relationships for this spending as for the overall C1 Segment spending, the impact would be a reduction in 2012 in-service additions of \$2.51 M and a reduction in 2013 in-service additions of \$5.64 M.

169. The Operations Capital Segment (C1) also includes \$48.4 M in pre-2012 CWIP that comes into service in 2012 and 2013. It is not clear what sub-components this CWIP is associated with. As the amounts excluded are small relative to the overall proposed in-service budget for Segment C1, VECC accepts that it is reasonable to include the pre-2012 CWIP in the non-discretionary budget for 2012 and 2013.

#### *IT Capital (C2) – THESL Application*

170. The IT Capital Portfolio consists of required hardware asset replacements, application upgrades and 2011 carry-over projects that need to be completed<sup>217</sup>.

#### *IT Capital (C2) – VECC Submissions*

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<sup>214</sup>Oral Hearing, Volume 1, page 82 and Evidentiary Update, Tab 4, Schedule C1, page 8

<sup>215</sup>Oral Hearing, Volume 1, page 83, lines 8-10

<sup>216</sup>Evidentiary Update, Tab 4, Schedule C1, page 9

<sup>217</sup>Evidentiary Update, Tab 4, Schedule C2, page 1

171. The proposed budget spending in this area is \$22 M for 2012 and \$15 M for 2013. In comparison, the annual capital spending on IT was over \$30 M in both 2010 and 2011<sup>218</sup>. Based on this, VECC accepts that it is reasonable to consider the 2012 and 2013 budget levels as non-discretionary.

*Fleet Capital (C3) – THESL Application*

172. The purpose of the Fleet Capital budget is to acquire new vehicles and equipment to replace those existing units that have reached the end of their service lives and where repairs/maintenance would not be appropriate or cost-effective<sup>219</sup>.

*Fleet Capital (C4) – VECC Submissions*

173. The proposed budget spending in this area is \$0.8 M for 2012 and \$2.0 M for 2013. In comparison, the annual capital spending on Fleet and Equipment was over \$10 M in both 2010 and 2011<sup>220</sup>. Based on this, VECC accepts that it is reasonable to consider the 2012 and 2013 budget levels as non-discretionary.

*Buildings & Facilities (C4) – THESL Application*

174. The Buildings and Facilities budget consists of spending required to maintain THESL's facilities at an adequate level of repair and to maintain compliance with various Codes and Acts<sup>221</sup>.

*Buildings & Facilities (C4) – VECC Submissions*

175. The proposed budget spending in this area is \$5 M for in each of 2012 and 2013<sup>222</sup>. In comparison, the annual capital spending on this area was \$12.1 M in 2010 and \$25.3 M in 2011<sup>223</sup>. Based on this, VECC accepts that it is reasonable to consider the 2012 and 2013 budget levels as non-discretionary.

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<sup>218</sup>VECC IR #112

<sup>219</sup>Evidentiary Update, Tab 4, Schedule C3, page 1

<sup>220</sup>VECC IR #112

<sup>221</sup>Evidentiary Update, Tab 4, Schedule C4, page 1

<sup>222</sup>Evidentiary Update, Tab 4, Schedule C4, page 2

<sup>223</sup>VECC IR #112



VECC's Overall ICM Eligibility Submissions

176. The following tables summarize the impact of VECC's specific recommendations regarding the amounts by Segment that should be considered eligible for ICM treatment.

<b>THESL 2012 CAPITAL SPENDING AND IN-SERVICE ADDITIONS</b>			
(\$ Millions)			
	<b><u>THESL Application</u></b>	<b><u>VECC's Proposed Reductions</u></b>	<b><u>VECC's Proposed</u></b>
	<b><u>In-Service Additions</u></b>	<b><u>In-Service Additions</u></b>	<b><u>In-Service Additions</u></b>
B1 - Underground Infrastructure	15.62	1.99	13.63
B2 - PILC Piece Out & Leakers	0.04	0.00	0.04
B3 - Handwell Replacement	8.62	4.31	4.31
B4 - Overhead Infrastructure	4.02	0.00	4.02
B5 - Box Constructions	0.26	0.10	0.16
B6 - Rear Lot Construction	11.70	11.70	0.00
B7 - Polymer SMD-20 Switches	0.00	0.00	0.00
B8 - SCADA-Mate R1 Switches	0.00	0.00	0.00
B9 - Network Vault and Roofs	1.26	0.00	1.26
B10 - Fibretop Network Units	0.65	0.00	0.65
B11 - ATS & RPB	0.00	0.00	0.00
B12 - Station Transformers	0.17	0.13	0.04
B13 - Station Switchgear	0.77	0.33	0.44
B14 - Stations Circuit Breakers	0.62	0.36	0.26
B15 - Stations Control & Communications Systems	0.06	0.06	0.00
B16 - Downtown Station Load Transfers	0.30	0.30	0.00
B17 - Bremner TS	0.00	0.00	0.00
B18 - Hydro One Contributions	3.69	0.00	3.69
B19 - FeederAutomation	1.02	1.02	0.00
B20 - Metering	2.59	0.00	2.59
B21 - Externally-initiated Plant Relocations/Expansions	6.97	2.21	4.76
BXXX - Understated Capitalized Labour	3.69	0.00	3.69
C1 - Operations Portfolio Capital	94.47	2.51	91.96
C2 - IT Capital	19.12	0.00	19.12
C3 - Fleet Capital	0.63	0.00	0.63
C4 - Buildings and Facilities	6.90	0.00	6.90
AFUDC (re C1-C4)	<u>0.15</u>	<u>0.00</u>	<u>0.15</u>
Total	183.30	25.02	158.30

Source: THESL Application - Exhibit J5.1

<b>THESL 2013 CAPITAL SPENDING AND IN-SERVICE ADDITIONS</b>			
(\$ Millions)			
	<b><u>THESL Application</u></b>	<b><u>VECC's Proposed</u></b>	<b><u>VECC's</u></b>
	<b><u>in-Service Additions</u></b>	<b><u>Reductions</u></b>	<b><u>Proposed</u></b>
	<b><u>in-Service Additions</u></b>	<b><u>In-Service Additions</u></b>	<b><u>In-Service Additions</u></b>
B1 - Underground Infrastructure	66.94	8.52	58.42
B2 - PILC Piece Out & Leakers	3.35	0	3.35
B3 - Handwell Replacement	19.03	9.52	9.51
B4 - Overhead Infrastructure	43.00	0	43.00
B5 - Box Constructions	14.34	5.38	8.96
B6 - Rear Lot Construction	27.02	27.02	0.00
B7 - Polymer SMD-20 Switches	0.93	0	0.93
B8 - SCADA-Mate R1 Switches	0.87	0	0.87
B9 - Network Vault and Roofs	13.00	0	13.00
B10 - Fibretop Network Units	5.85	0	5.85
B11 - ATS & RPB	1.99	0	1.99
B12 - Station Transformers	2.33	0.53	1.80
B13 - Station Switchgear	18.91	10.75	8.16
B14 - Stations Circuit Breakers	0.76	0.45	0.31
B15 - Stations Control & Communications Systems	0.69	0.69	0.00
B16 - Downtown Station Load Transfers	2.34	2.34	0.00
B17 - Bremner TS	0.00	0	0.00
B18 - Hydro One Contributions	18.42	16.94	1.48
B19 - FeederAutomation	13.86	13.86	0.00
B20 - Metering	10.35	0	10.35
B21 - Externally-initiated Plant Relocations/Expansions	22.07	10.21	11.86
BXXX - Understated Capitalized Labour	4.63	0	4.63
C1 - Operations Portfolio Capital	151.88	5.64	146.24
C2 - IT Capital	21.47	0	21.47
C3 - Fleet Capital	0.76	0	0.76
C4 - Buildings and Facilities	2.89	0	2.89
AFUDC (re C1-C4)	2.14	0	2.14
<b>Total</b>	<b>469.81</b>	<b>111.85</b>	<b>355.83</b>
Source: THESL Application - Exhibit J5.1			

177. In addition to the above specific reductions, VECC's preceding submissions identified specific Segments (i.e., B1, B2 and B4) where there was an outstanding issue as to whether all of the proposed work shown under the VECC Recommendations Column really needed to be completed in the proposed ICM period. In VECC's view this question arises primarily with respect to the 2013 in-service additions for where the specific reductions recommended still leaves

\$104.79 M of in-service additions for these three segments. VECC submits that the Board should further reduce the 2013 total for these three Segments recognizing the concern regarding pacing, the asymmetry of information available to parties other than the Applicant and the fact that ICM non-discretionary considerations need to be stringently applied if the integrity of the Board's overall IRM pricing setting approach is to be maintained.

178. In terms of implementation, the Board should require THESL to identify, as part of the Draft Rate Order process, its proposal as to how this cut should be allocated across the three Segments.

179. Finally, once the overall reductions have been established the Board should direct proportional adjustments to Segment BXXX and to Segment C1 – Engineering Capital (based on the reductions in Segments C1-C4).

#### *General Filing Requirements – OM&A Savings*

180. The Filing Guidelines set out in the EB-2007-0673 Supplemental Report of the Board require<sup>224</sup> ICM applications to include “*Evidence that the incremental revenue requested will not be recovered through other means*”. One such means is reduced OM&A savings. However, THESL's application did not include any mention of such savings. VECC asked a number of interrogatories on this issue and the reputed savings were \$90,000 over 2012-2014<sup>225</sup>. VECC notes that this value only covers the savings attributable to four segments but, even then, given the extensive work and asset replacement that THESL's ICM application involves VECC finds it difficult to accept that the annual OM&A savings would only be in the order of \$30,000.

181. VECC submits that for purposes of determining any ICM related revenue requirement the Board should impute an OM&A savings of at least \$100,000 per annum.

#### *General Filing Requirements – Detailed Revenue Requirements by ICM Project*

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<sup>224</sup>Appendix B, page VII

<sup>225</sup>Exhibit J5.9 and the associated VECC IR responses

182. The Board's Filing Guidelines require<sup>226</sup> "*Calculation of the revenue requirement associated with each proposed incremental non-discretionary capital project (i.e. the cost of capital, depreciation, and PILs)*" – emphasis added. As noted earlier, THESL has not done this. For purposes of the supporting Workforms<sup>227</sup> it has included its entire proposed ICM capital amount as one project. Furthermore, in all its discussion of various approaches and options it has used a simple 10% recovery factor to determine the revenue requirement impacts.

183. In reality, each segment involves different types of assets and the revenue requirement per dollar spent and per dollar of in-service additions will vary. Therefore, the overall ICM revenue requirement to be recovered will depend upon how much of the spending for each segment and the types of jobs from each segment the Board approves for purposes of the ICM.

184. VECC also notes that Board's EB-2007-0673 Supplemental Report includes the following reporting requirements<sup>228</sup>:

*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*

185. In order for the Board to effectively carry out its planned prudence review and its review of the difference between forecast and actual spending during the IR plan term, VECC submits it will need more information than just the total capital approved and total capital spent for each year. It will need details, at minimum by segment, regarding the planned and then actual spending. VECC submits that, at this stage in the proceeding, these needs are best addressed during the rate implementation (i.e., the Draft Rate Order) process.

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<sup>226</sup>Filing Requirements for Electricity Transmission and Distribution (June 2012), Chapter 3, page 10

<sup>227</sup>Sheet E3.1

<sup>228</sup>Appendix B, page VII

**2.3 Is THESL's proposal that the Board consider ICM projects for a three-year period, severable into three successive one-year rate periods, each with its own ICM rate adder appropriate?**

186. The EB-2007-0673 Supplemental Report of the Board envisioned that an IRM application (which is for a single year's rates) could be accompanied by an ICM application which would also be for a single year. VECC submits that this is clear from the amended filing guidelines set out in the Report<sup>229</sup>, which directed that an ICM application would include:

*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 (emphasis added);*

187. In this regard, THESL's application is exception as all other ICM applications to-date have been based on one-year's spending. However, with the Evidentiary Update which bifurcated the application such that the 2012-2013 spending would be considered first and, then, the 2014 spend at a later date the Application starts to look more like what the Board expected. VECC also notes that with the passage of time, it is really impractical, at the time of the Evidentiary Update, for the 2012-2013 period to be further bifurcated and the 2012 ICM Application to be considered first on a stand-alone basis. Indeed, by the time the Evidentiary Update was filed on October 31, 2012 the filing the 2013 IRM filing deadlines had past for all but the 6<sup>th</sup> tranche which was due November 6, 2012.

188. As a result, treating the 2012-2013 Application as two successive one-year ICM applications and then dealing with 2014 in separate phase – akin to a separate application – was the only reasonable way for the Board to proceed.

189. However, as VECC has noted earlier, the Board's Renewed Regulatory Framework for Electricity Distributors provides another option starting in 2014 to those distributors who have identified a potential issue with multi-year capital spending/in-service additions over their future IRM period. This option is the Customer IR. VECC submits that the Board should make it clear in its decision

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<sup>229</sup>Appendix B, page VI

regarding THESL's application that it will not consider an ICM application that involves multiple years starting in 2014 or after.

**2.4 Is THESL's proposal for an alternative to the standard treatment of the calculation of the ICM threshold together with the Board's practice of exempting certain ICM-approved capital expenditures from the application of the half year rule appropriate?**

190. THESL filed its ICM application following the Board's approved approach which included the specified threshold test with a 20% dead band and determination of the ICM-approved revenue requirement without application of the half-year rule except in the year immediately preceding rebasing<sup>230</sup>.
191. In its Application, THESL also offered an alternative whereby the dead band would be dropped but the half-year rule would be applied to capital addition the first year they came in-service for all IRM years<sup>231</sup>.
192. VECC appreciates that part of the rationale for the proposal was "rate mitigation" but notes that this mitigation was required in large part because THESL framed its application using a "capital spend" model as opposed to an "in-service additions" model. An issue which has already been dealt with earlier in these submissions.
193. VECC is also concerned that were the Board to adopt THESL's proposed alternative it would signal to other distributors that variations on the Board's standard ICM approach are acceptable and encourage distributors to offer their own variation on the ICM. VECC notes that considerable effort and consultation went into the design of the initial ICM leading to the Board's EB-2007-0673 Reports. VECC also notes that other than removing the "unusual" and "unanticipated" requirements, the current approach to the ICM was confirmed in the Board's recent Renewed Regulatory Framework for Electricity Distributors Report<sup>232</sup>. VECC submits that the Board should not now approve THESL's alternative approach and, in doing so, invite other distributors to propose their own versions of the ICM.

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<sup>230</sup>Pre-filed Evidence, Tab 2, pages 10-11

<sup>231</sup>Pre-filed Evidence, Tab 2, page 11

<sup>232</sup>Page 18

### **ISSUE 3      Deferral and Variance Accounts**

#### **3.1 Is the proposed final disposition of the PILs Deferral Account 1562 appropriate, including the proposed rate riders?**

194. VECC has reviewed Board Staff's submissions on this issue and notes that they are quite extensive and thorough. As a result, VECC has not undertaken to provide separate submissions on this issue.

#### **3.2 Is the proposed final disposition of all remaining Deferral and Variance Accounts (i.e. the Group 1 Accounts as well as the Special Purpose Charge Variance Account 1521) appropriate, including the proposed rate riders?**

195. VECC agrees with Board Staff's submissions on this issue.

### **ISSUE 4      Implementation**

#### **4.1 Has THESL appropriately complied with the Final Order Regarding Suite Metering Issues dated April 26, 2012 in EB-2010-0142 including its use of the name "Competitive Sector Multi-Unit Residential" for the new Quadlogic class?**

196. The Competitive Sector Multi-Residential class is defined as being applicable to "accounts where the electricity is used exclusively for residential purposes in a multi-residential building, where unit metering is provided using technology that is substantially similar to that employed by competitive sector sub-metering providers"<sup>233</sup>.

197. When THESL was asked how it would establish on an ongoing basis what types of meters are "substantially similar to that employed by competitive sector sub-metering providers" the Company responded that it is continuously aware of the various sub-metering technologies available in the market. THESL went on to state that it will determine what is "substantially similar" based on the meter application and the meter type.

198. VECC's concern with respect to this definition of the Competitive Sector Multi-Unit Residential Class and, by default, the definition of the Residential Class<sup>234</sup> is

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<sup>233</sup>Pre-filed Evidence, Tab 3, Schedule B1, page 2

<sup>234</sup>Pre-filed Evidence, Tab 3, Schedule B1, page 1

that it does not provide clarity to customers who are served from these schedules as to which of the two classes they fall into and appears to leave the determination largely to the discretion of THESL. VECC submits that there should be, at minimum, some record or documentation clarifying what types of meters fit this definition. This could be done either through THESL's Conditions of Service or through its rate filings.

#### **4.2 Are THESL's proposals relating to rate implementation appropriate for each of the years 2012, 2013 and 2014?**

199. Rate implementation issues include: a) the effective dates for any 2012 and 2013 rate changes, b) foregone revenue rate riders, c) the draft rate order process and d) the "true-up" process for the ICM. Each of these is discussed below.

##### *Effective Date*

200. THESL has requested a June 1, 2012 effective date for its 2012 IRM/ICM application and a May 1, 2013 effective date for its 2013 IRM/ICM application<sup>235</sup>.

201. With respect to the 2012 IRM/ICM application and related rate changes, VECC submits that an effective date of November 1, 2012 is more appropriate. This date recognizes that THESL filed major revisions to its Application on October 31, 2012.

202. For the 2013 IRM/ICM Application, VECC agrees that May 1, 2013 is the appropriate effective date.

203. THESL has also requested that the 2012 ICM revenue requirement be recovered through rate riders effective from May 1, 2013 through to April 30, 2015. Based on VECC's submission there would be no 2012 ICM revenue requirement. However, if the Board determines differently, VECC submits that it may be more beneficial from a rate smoothing perspective to have the rider effective until April 30 2014. VECC's rationale is based on the expectation that the 2012 ICM revenue requirement is likely to be relatively small and that the ICM-driven rate increases for April 1, 2014

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<sup>235</sup>Evidentiary Update, Tab 2, page 21



may well be higher than those for 2012 and 2013. Having this rate rider cease for May 1, 2014 may provide some necessary rate relief.

#### *Foregone Revenue Rate Riders*

204. THESL asks that the Board establish a foregone revenue rate rider that allows it to recover any incremental revenue approved for the period between when the rates became effective and when new rates were implemented. Given the current timing of the proceeding this request is not likely to be required for the May 1, 2013 IRM/ICM rate effective date but will be required to address the effective date for the IRM portion of the 2012 rate adjustment. VECC agrees that such a rider is appropriate and submits that it should be calculated on the basis that it will be in effect from the date the 2012 IRM rate changes are implemented to April 30, 2014.

#### *Draft Rate Order Process*

205. VECC expects that in its Decision regarding THESL's ICM application the Board will make determinations regarding:

- The amounts in each proposed ICM Segment (i.e., B1 to B22) that the Board approves as being eligible for ICM treatment in 2012 and 2013 respectively and, if a portion of the spending has been "disallowed" what the nature of the related activities is,
- The amount to be considered as THESL's total non-discretionary budget for each of 2012 and 2013 including the approved ICM Segment spending and the non-discretionary spending for Segments C1 through C4.

206. The final amount of spending/in-service addition eligible for ICM recovery is the lesser of:

- a) the difference between THESL's total non-discretionary budget and the ICM threshold, and
- b) the total amount of ICM Segment spending/in-service additions accepted as meeting the ICM eligibility criteria.

207. In order to comply with this requirement and provide the information necessary for adequate reporting and review of the actual ICM capital spending, VECC submits that Draft Rate Process must involve the following steps when it comes to the ICM:

- I. The Board should direct THESL as part of the Draft Rate Order process to designate which ICM eligible Segments (or part thereof) - up to the allowed total spending/in-service additions amount - THESL proposes to use for purpose of determining the ICM revenue requirement to be recovered.
- II. The Board should also direct THESL to specify (if required in order to meet any spending reductions directed for the ICM eligible Segments) the sub-set of the specific jobs set out in the Evidentiary Update that it plans to undertake in 2012 and 2013.
- III. THESL should then be directed to use this information to determine the ICM rate rider for each year.

#### *True-Up Process*

208. As noted previously, the Board's EB-2007-0673 Supplemental Report<sup>236</sup> 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*

209. VECC submits that the prudence review to determine the amounts to be incorporated in rate base at the time of rebasing is not a new requirement as all rebasing applications consider the appropriateness of the opening net fixed asset balance for purposes of setting rates on a going forward basis. What is new, in this instance, is that the Board and other parties, have a forecast of the planned spending and details as to what the spending was to achieve which can assist in determining the prudence of the actual spending incurred.

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<sup>236</sup> Appendix B, page VII

210. However, the second review, which involves the “treatment of differences between forecast and actual spending during the IR plan period”, is not standard. During a typical IR plan period there is no “spending forecast”. However, the ICM is far from typical, particularly within the context of an IRM period. It permits the distributor to collect additional revenues from its customers on the basis that they are meant to be directed/used for specific purposes. As a result, it is legitimate for the customers and the Board to ask, after the fact, whether the dollars collected were spent for the intended purposes. This should be the objective of the second part of the review.

211. THESL envisions the review as a true-up process where they (and customers) are held harmless for any differences between the ICM revenues collected and the revenue requirement associated with the amount actually spent<sup>237</sup>. VECC submits that this approach is inappropriate. VECC submits that the ICM should be viewed as a “contract” by the distributor to undertake certain results that were deemed to be non-discretionary at a “price” that was considered to be prudent. Through the ICM rate rider customers will have met their part of the contract. VECC considers the true-up as being a determination as to whether the distributor has “delivered” on its side of the contract and whether a “refund” is due to customers if it has not.

### **Recovery of Reasonably Incurred Costs**

212. VECC submits that its participation in this proceeding has been focused and responsible. Accordingly, VECC requests an award of costs in the amount of 100% of its reasonably-incurred fees and disbursements.

All of which is respectfully submitted this 15th day of January 2013.

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<sup>237</sup>Oral Hearing, Volume 5, pages 15-16