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

BY EMAIL

September 18, 2024

Ms. Nancy Marconi
Registrar
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4
Registrar@oeb.ca

Dear Ms. Marconi:

Re: Toronto Hydro-Electric System Limited (Toronto Hydro)
2025-2029 Custom Rate Application for Electricity Distribution Rates
Ontario Energy Board (OEB) File Number: EB-2023-0195

Pursuant to Procedural Order No. 7, this is OEB staff's submission on Toronto Hydro's proposed Innovation Fund related to its 2025-2029 Custom Rate Application.

Thank you,

Thomas Eminowicz
Digitally signed by Thomas Eminowicz
Date: 2024.09.18 12:45:20 -04'00'

Thomas Eminowicz
Senior Advisor

Encl.
cc: All parties in EB-2023-0195

ONTARIO ENERGY BOARD

OEB Staff Submission

Toronto Hydro-Electric System Limited

2025-2029 Custom Rate Application for Electricity Distribution Rates

EB-2023-0195

September 18, 2024

Summary of Toronto Hydro's Proposed Innovation Fund

Toronto Hydro has proposed, as a component of its custom incentive rate-setting framework, an Innovation Fund.[1] Toronto Hydro states that it has proposed this fund to support innovative pilot projects over the 2025-2029 rate term that would be focused on enabling electrification grid readiness and responding to the OEB's expectations with respect to facilitating Distributed Energy Resource (DER) integration.[2] Toronto Hydro states that the fund is proposed to address needs that are not adequately met by existing funding mechanisms. Toronto Hydro states that existing mechanisms tend to support spending where beneficial outcomes are more proven or certain, and that expenses must be classified as either capital or operating expenses.[3]

Toronto Hydro identifies four pilot project "concepts" that *could* be supported by the Innovation Fund: flexible connections, electric vehicle commercial fleet charging, electric vehicle demand response, and advanced microgrids.[4] Toronto Hydro states that the work is focused on nascent, development work that has uncertainty with respect to deploying it as part of standard distribution system solutions.[5]

Toronto Hydro has proposed a governance framework to design, execute, evaluate, and account for pilot projects with the principle aim of enabling new distribution capabilities.[6] This framework would be executed by a steering committee exclusively internal to Toronto Hydro.[7] In the proposal, several reports are planned, but only the final evaluation and lessons learned report would be made available to the public.[8]

Toronto Hydro has proposed to allocate 0.3% of its proposed revenue requirement to the Innovation Fund.[9] OEB staff interprets this to mean that the proposal would reflect the filed Settlement Proposal, which reduced the total revenue requirement.[10] With this understanding, OEB staff interprets the proposal to be an Innovation Fund of

[1] Exhibit 1B, Tab 2, Schedule 1, p. 4
[2] Ibid. p. 33
[3] Exhibit 1B, Tab 4, Schedule 2, p. 4
[4] Ibid. Appendix A
[5] Interrogatory Response 1B-Staff-99, part f)
[6] Exhibit 1B, Tab 4, Schedule 2, pp. 8-16
[7] Technical Conference Transcript, Day 4, p. 132
[8] Interrogatory Response 1B-SEC-29, part a)
[9] Exhibit 1B, Tab 2, Schedule 1, p. 34
[10] Settlement Proposal, Table 2

approximately $15 million. OEB staff invites Toronto Hydro to confirm this detail for the OEB in its reply submission.

Toronto Hydro states its intention to collect the revenues for this fund with a rate rider, further stating that this will provide transparency to ratepayers via the Tariff Sheets.[11] [12] Toronto Hydro proposed to collect the revenues for the Innovation Fund by a one-year rate rider starting January 1, 2029.[13]

In addition to the proposed fund and associated rate rider, Toronto Hydro has also proposed a variance account: the Innovation Fund Variance Account.[14] Toronto Hydro proposes that this variance account track the variances between the revenues collected through the Innovation Fund Rate Rider and the actual costs incurred by the Innovation Fund pilot projects by the end of the rate period.[15]

Toronto Hydro has also confirmed that it does not propose there to be a limit to the actual expenditures.[16] Toronto Hydro states that the proposed amount of 0.3% reflects the lower end of the range of utility investment in comparable innovation activities. While Toronto Hydro views a "hard cap" as a limitation to flexibility, Toronto Hydro does view regulatory oversight as a measure to moderate the risk of overspending. Toronto Hydro states that it "does not intend to stray far outside of its boundaries, unless there is a strong value proposition for doing so."[17]

Toronto Hydro states that the proposed variance account meets the eligibility requirements for establishing a new deferral or variance account on the following basis:[18]

> Causation: The proposed funding is outside the base revenue requirement and the projects would not form part of the utility's base revenue requirement.
> Materiality: The amounts would be based on actual expenditures incurred to execute the projects selected in accordance with the proposed governance framework. With respect to the impact to operations, Toronto Hydro states that

[11] Exhibit 1B, Tab 2, Schedule 1, p. 34
[12] Interrogatory Response 1B-Staff-13, part b)
[13] Interrogatory Response 9-Staff-342, part a)
[14] Exhibit 1B, Tab 4, Schedule 2, p. 1
[15] Interrogatory Response 9-Staff-342, part a)
[16] Interrogatory Response 1B-CCC-46, part h)
[17] Interrogatory Response 9-Staff-342, part a)
[18] Exhibit 1B, Tab 4, Schedule 2, pp. 16-17

the pilot projects are necessary pre-requisites to scaling them to cost-effective programs or solutions.[19]
Prudence: The forecast, or planned amount, of 0.3% of revenue requirement is reasonable based on a comparison to other jurisdictions, and by the governance framework that Toronto Hydro has proposed.

OEB staff notes that Toronto Hydro does not propose an after-the-fact prudence review of the pilot project costs and benefits. Toronto Hydro states that having to demonstrate the prudency of innovation-driven pilot projects on the basis of costs and benefits is a barrier to innovation. Toronto Hydro states that its internal governance framework ensures prudent deployment of the funds.[20]

OEB Staff Submission

OEB staff supports distributors, including Toronto Hydro, being responsive to the OEB's guidance and expectations that distributors modify their planning and operations to prepare for DER impacts on their systems, including integrating these resources cost-effectively, while maintaining reliable service for their customers as set out in the Framework for Energy Innovation Report.[21] OEB staff notes that a separate innovation fund is not an item prescribed by the OEB, so consideration of the appropriateness and merits of Toronto Hydro's proposal is necessary to both determine if these activities should be funded by ratepayers at this time, and if so, ensure reasonable and prudent use of ratepayer funding.

OEB staff's support of distributors in innovation is informed by the OEB's strategic initiative on facilitating innovation. The OEB facilitates innovation that can provide demonstrable value to Ontario's consumers and solve energy challenges cost effectively. It is important to provide clear direction on when and how regulated utilities can recover the costs for activities related to innovation from ratepayers and how this risk is addressed. Finally, the strategy states that the OEB continually evaluates which activities or emerging needs are better undertaken or addressed through competitive markets.[22]

OEB staff recognizes Toronto Hydro's novel proposal to afford greater flexibility for exploring innovative investments. However, OEB staff does not support Toronto Hydro's

[19] Undertaking Response JT4.34
[20] Interrogatory Response 1B-CCC-46, part d)
[21] Report: Framework for Energy Innovation: Setting a Path Forward for DER Integration, January 2023
[22] The Ontario Energy Board's 2024-2027 Business Plan, p. 15

proposal as filed since the proposal does not include a level of rigor and prudency commensurate with the flexibility Toronto Hydro seeks. OEB staff's greatest concern is the difficulty with which to confirm that expenditures funded through a custom mechanism are truly outside of base rates and that existing OEB mechanisms are insufficient in meeting the need. OEB staff is not convinced that funding through a rider in the 2025-2029 term is necessary.

OEB staff submits that, with several enhancements to the proposal, a capped deferral account to recover innovation related operating expenditures could be supported. OEB staff does not support capital related expenditures for this account. Further characteristics are as follows:

- A prudence review with respect to pilot project selection is critical to establish that the work is truly exploratory and pursing developmental work that should not otherwise be funded by base rates and that external funding sources are insufficient or not applicable.
- A prudence review with respect to project execution.
- A modified prudence review regarding results that requires Toronto Hydro to demonstrate that there was a reasonable prospect for learning valuable lessons at the time of project selection and that this prospect did not diminish over the course of execution.
- A soft-limit on spending where deferral account additions in excess of the limit are not driven by taking on additional projects.

The meaning of a "soft-limit" is intended to recognize that prudently selected and executed pilot projects may exceed the approved level of the fund. Similarly, the soft-limit is intended to maintain a level of prioritization with respect to project selection when Toronto Hydro assesses the "value propositions" of each. OEB staff submits that, it is plausible that a planned portfolio of $14.5 million for a $15 million fund could prudently complete the work with more than $15 million of expenditures. However, OEB staff submits that a soft-limit should not be an invitation to take on an addition $1 million pilot project in this hypothetical scenario.

While OEB staff does not support the proposed Innovation Fund Rate Rider, if the OEB is convinced through other submissions that Toronto Hydro should be provided additional funding in the 2025-2029 term, OEB staff submits that provision be made for claw-back should Toronto Hydro fail to demonstrate prudence as per the above.

The balance of this submission details OEB staff's concerns and provides details regarding the remediating measures. Broadly, there are four core considerations: the scope of projects, pilot project selection and execution, the appropriate level of funding,

and the rate funding mechanism. Each of these areas are detailed in turn. Finally, OEB staff addresses Toronto Hydro's eligibility criteria to establish its proposed Innovation Fund Variance Account.

Scope of Projects for the Innovation Fund

The first area for consideration is the scope of any potential innovation activities. OEB staff agrees that "innovation" is difficult to define and that Toronto Hydro should be afforded flexibility in selection and execution of pilot projects. Therefore, OEB staff agrees with Toronto Hydro that it is unlikely to be feasible to concretely identify all innovation projects that would appropriately be funded outside of base rates in this proceeding for the entire 2025-2029 term.

Toronto Hydro identified the following areas to be included as part of its innovation projects:

1. The use of new technology or new ways of using existing technology;
2. Innovative business practices, including relationships with others to enhance services to customers and share costs; or
3. Enhancing distribution services in a way that benefits customers, including facilitating customers' ability to innovate in how they receive distribution services.

OEB staff notes that the areas Toronto Hydro proposes to pursue are consistent with the OEB's Chapter 2 Filing Requirements.[23] OEB staff also notes that these requirements are in the context of applications for distribution rates, meaning, that some level of innovation is expected to be part of the normal course of business for a utility.

The pilot project concepts identified for the 2025-2029 rate period are: a) Flexible Connections; b) Electric Vehicle Commercial Fleet Charging, c) Electric Vehicle Demand Response, and d) Advanced Microgrids.[24] OEB staff notes that "EV Demand Response" is listed as a 2020-2024 rate funded innovation initiative.[25] OEB staff questions the notion that the base rates that funded this pilot project in the past is insufficient to fund a similar project in the future period.

OEB staff notes that the above project concepts are characterized as those that *could be supported* by the proposed fund, meaning that Toronto Hydro is not committing to

[23] Filing Requirements for Electricity Distribution Rate Applications – 2023 Edition for 2024 Rate Applications, Chapter 2, Cost of Service, December 15, 2022, Section 2.1.7, pp. 13-14
[24] Exhibit 1B, Tab 4, Schedule 2, Appendix A
[25] Interrogatory Response 1B-CCC-42

undertaking these concepts.[26] [27] Additionally, OEB staff notes that in the evidence relating to the Distribution System Plan, Toronto Hydro states that a program within its capital plan, the Modernization plan, was revised by reallocating funding from the Distribution System Plan to the Innovation Fund.[28] Finally, OEB staff notes that Toronto Hydro has stated that it's Distribution System Plan is not a "project-based Distribution System Plan."[29] From these facts, OEB staff concludes that not only is it difficult to ascertain what work would be pursued under an Innovation Fund, but it is also ambiguous as to what is outside base rates.

Toronto Hydro has provided a summary of its past examples of developing and executing innovative initiatives over the 2020-2024 rate period.[30] Amongst the individual projects that have been pursued in the past, Toronto Hydro implemented a self-funded internal Innovation Sandbox challenge to engage and encourage employees to bring forward ideas for proof of concept projects that are novel and provide value to customers. This led to several projects, including Virtual Reality Training and its System Observability: Network Condition, Monitoring and Control technology to be scaled and implemented into its regular business practices.

These examples are encouraging and show the ability of distributors to leverage internal expertise through the use of proper incentives and motivators to develop new ideas. Toronto Hydro has stated that a key component of the Innovation Fund proposal is to continue the work from this internal sandbox.[31]

Furthermore, Toronto Hydro states that key differentiators for work funded by the proposed Innovation Fund include adapting operational practices to manage DERs, modifying planning processes to incorporate non-utility DER solutions, and developing skills and knowledge within the organization.[32] OEB staff submits that these are not examples of "innovation" that should be afforded a separate and custom funding mechanism, but rather examples of good business practice. To put this notion another way, OEB staff submits that it is not the purpose of base rates to preserve the status quo. Just as a distributor is obligated to build, operate, and maintain its system for both today and tomorrow, the methods and manner in which it does so should be equally

[26] Exhibit 1B, Tab 4, Schedule 2, p. 8
[27] Technical Conference Transcript, Day 4, pp. 97-99
[28] Exhibit 2B, section E2, p. 10
[29] Technical Conference, April 8, 2024, Transcript, p. 65
[30] Exhibit 1B, Tab 4, Schedule 1, pp. 2-12
[31] Interrogatory Response 1B-CCC-42
[32] Interrogatory Response 1B-Staff-99, part d)

responsive and reflective of the same.

Toronto Hydro should continue to use a portion of its OM&A and capital funding to support its internal Innovation Sandbox as it has done through the 2020-2024 rate period. Furthermore, OEB staff submits that there is nothing in the Settlement Proposal that precludes these types of activities from being funded by the settled capital and operating expenditures.

Where OEB staff does see Toronto Hydro providing a more distinct idea of the scope is in Toronto Hydro's statements regarding emergent technologies that could still be in the development stage. Toronto Hydro states that these types of technologies likely require additional development before scaling to deployment at the level of distribution system solutions.[33] OEB staff does see merit in this type of work and submits that it is reasonable for there to be difficulty in providing definitive project definition or budgets years in advance. OEB staff therefore invites Toronto Hydro to consider better defining "innovation" in the context of a custom funding mechanism. Toronto Hydro should confirm the nature of the pilot projects that are distinct from what was funded through base rates in the past and what should reasonably continue to be funded through base rates.

As a result, OEB staff submits that any approved funding mechanism for innovation must include the requirement to demonstrate that the scope of any expenditures is outside what should be funded through base rates and also that no other funding mechanism was available to Toronto Hydro. Any such mechanism should not be used to fund work that Toronto Hydro has simply chosen to exclude from its business plan. The decision to use a custom funding mechanism for these innovation expenditures must be supported by developed business cases for demarcating the work from the operating and capital expenditures funded by base rates.

Pilot Project Selection and Execution

Toronto Hydro has proposed a governance framework to guide the development, selection and execution of pilot projects. The governance framework proposal includes an internal steering committee of senior leaders to oversee the four-phases of pilot selection, design, execution, and evaluation. Toronto Hydro proposes that this committee would be responsible for key decisions including scope, budget, and

[33] Interrogatory Response 1B-Staff-99, part f)

timelines.[34]

Pilot project selection would begin with the internal steering committee, with an assessment of potential business value, feasibility, opportunity for scale, and opportunities to leverage external funding. Toronto Hydro states it would canvas external stakeholders, as it deems relevant, for the purpose of an internal project selection report that the steering committee would use to inform project selection.[35] [36] Toronto Hydro indicated it will begin with the pilot selection phase after the OEB's Decision and Order, followed by the pilot design phase within the first 18 months of the rate period as the pilot projects may require multiple years of testing.[37]

OEB staff notes that the examples of innovation funds from other jurisdictions that Toronto Hydro has provided did not use this type of governance model. Rather, utility commissions or the state department of public service determines how the funding is spent not the utility itself.[38] OEB staff sees this as in important distinction that weakens the proposal. OEB staff submits that focused prudence reviews and timely public reporting are necessary remediating measures.

With respect to reporting, Toronto Hydro proposes that it would produce three reports relating to pilot selection, milestone, and evaluation. But only the final pilot evaluation and learnings report would be shared with the OEB for the OEB to distribute to stakeholders.[39]

OEB staff submits that Toronto Hydro's proposed public reporting is inadequate. OEB staff submits the milestone report and completion report should be posted to Toronto Hydro's website in a timely manner. This is consistent with the OEB's decision in Essex Powerlines approved PowerShare Deferral Account.[40] Furthermore, OEB staff submits that the pilot selection report will be crucial to demonstrating prudent decision making. All three reports should be provided as part of a prudence review on how Toronto Hydro has exercised a custom funding mechanism for innovative pilot projects.

OEB staff submits that a prudence review of project selection must demonstrate that Toronto Hydro selected projects with a reasonable expectation of scalability, identifying

[34] Exhibit 1B, Tab 4, Schedule 2, pp. 8-9
[35] Ibid. pp. 9-11
[36] Interrogatory Response 1B-CCC-46, part a)
[37] Ibid. part i)
[38] Undertaking Response JT3.36
[39] Exhibit 1B, Tab 4, Schedule 2, p. 16
[40] Decision and Order, EB-2024-0096, August 29, 2024, pp. 14-15

the expected lessons to be learned. Prudent execution is equally critical. OEB staff submits a modified approach to prudence review regarding outcomes, that is focused on sound selection and execution would be appropriate for pilot projects that seek to establish developing distribution system solutions.

OEB staff submits that Toronto Hydro should be required to include evidence in its final pilot evaluation reports that explain the criteria used to select projects, including business value, feasibility, scalability, and external funding. OEB staff submits that the question of prudent project selection should also consider as many of the following considerations as possible: how each project has the potential to provide value to ratepayers through the reduction of future capital investments, reduction in OM&A budgets, increased efficiency of its existing system, and increase opportunities for customers, including the ability to better manage usage to reduce overall consumption or shift periods of usage and the ability to increase level of customers to connect DERs.

Funding Amount for the Innovation Fund

The level of funding provided outside of base rates for innovation is another critical consideration. Toronto Hydro has stated that it forecasts to spend its proposed "Innovation Fund allotment" of 0.3% of revenue requirement.[41]

To consider the level of funding associated with innovative projects, OEB staff looks to previous work that is similar. Toronto Hydro has provided examples of several successful innovative projects from the current rate term:[42]

- Etobicoke Demand Response Pilot: $2 million rate-funded by Toronto Hydro with $2 million from IESO Grid Innovation Fund
- EV Demand Response Pilot: less than $0.5 million
- Innovation @ TH: less than $1 million

Based on the above, Toronto Hydro would need to significantly ramp up its innovation initiatives for historical expenditures to rise to the proposed level of the fund. Toronto Hydro has indicated that the proposed allotment is "on the lower end" of the comparative jurisdictional review.[43]

OEB staff questions the validity of the comparison on two grounds. First, comparator

[41] Interrogatory Response 9-Staff-342, part f)
[42] Interrogatory Response 1B-CCC-42
[43] Interrogatory Response 9-Staff-342, part a)

innovation funds were all administered by regulators or state departments.[44] The evidence is unclear how these comparator "innovation funds" distributed the funds to the various utilities within the applicable jurisdiction. Second, since the research indicates the fund was administered by regulators or state departments, the governance framework, and thus the risk to ratepayers regarding the use of the funds, is a fundamental difference that weakens the linkage between the research and what Toronto Hydro has proposed. As a result, OEB staff submits that the jurisdictional review is not informative in determining an appropriate level for the fund. Therefore, OEB staff submits that historical expenditures and a view of how the future will unfold is the best that is available given the evidentiary record.

OEB staff does consider that it is possible that Toronto Hydro's historical record is not entirely indicative of the future and that Toronto Hydro will be spurred to increase the level of innovation. OEB staff also submits that an appropriate funding mechanism would be a pre-requisite to pursuing the work. As a result, OEB staff submits that, with appropriate controls, a custom funding mechanism of $15 million is reasonable.

Rate Mechanism for Innovation Fund

The preceding sections have addressed OEB staff's concerns with respect to the scope and execution of Toronto Hydro's proposed Innovation Fund. The following will address concerns regarding the proposed rate funding mechanisms: the Innovation Fund Rate Rider and the Innovation Fund Variance Account. The proposed variance account will be addressed first.

OEB staff submits that the proposed variance account is not a variance account, but rather a deferral account. A variance account tracks the difference between actual costs and those forecast. Toronto Hydro has not provided a forecast of innovation expenditures, but instead an "allotment" has been applied to a fund.[45] [46] Furthermore, as noted above, Toronto Hydro has also not provided a concrete definition of the work itself. Therefore, OEB staff submits that both the costs and the actual nature of the costs are unknown at this time.

OEB staff also notes that the variance account is proposed to track the difference between expenditures and revenues collected through the proposed rate rider.[47] As a

[44] Undertaking Response JT3.36
[45] Interrogatory Response 9-Staff-342, part f)
[46] Interrogatory Response 1B-CCC-46, part h)
[47] Interrogatory Response 9-Staff-342, part a)

result, OEB staff submits that the proposed account is not intended to track variances based on expected expenditures, but is instead a revenue true-up mechanism.

Therefore, OEB staff submits that what Toronto Hydro actually seeks is a deferral account to support the execution of innovative pilot projects. OEB staff accepts that the exact projects are uncertain and that the exact expenditures are equally uncertain. OEB staff submits that if this custom funding mechanism is granted by the OEB, it should be a deferral account and that for clarity the OEB should consider naming it the "Innovation Deferral and Execution Account" – IDEA.

Toronto Hydro has proposed that the Innovation Fund's amount be collected through a rate rider in 2029, stating that this will provide transparency to customers regarding the Innovation Fund.[48] OEB staff questions the benefit to transparency that a 2029 rate rider would provide to Toronto Hydro's customers.[49] OEB staff submits that timely public reporting of project milestone and results reports would provide significantly greater transparency to Toronto Hydro's customers and stakeholders than would a rate rider on the Tariff Sheets.

With respect to the rate rider itself, OEB staff questions why it would be reserved to the last year of the rate term. Toronto Hydro has stated that the work would commence prior to 2029. This timing suggests that additional funding is not required for these pilot projects, otherwise Toronto Hydro would have proposed either earlier funding or funding that is spread out over the 2025-2029 term. This only further bolsters the notion that a deferral account is actually what Toronto Hydro is proposing.

Another issue is Toronto Hydro's plan to treat the fund on a revenue requirement basis.[50] Under this model, it is possible that innovation expenditures could be capitalized and would attract depreciation and return on capital costs beyond 2029. The OEB's Handbook for Utility Rate Applications cautions that capital expenditures should be scrutinized, and that it is particularly important that planning be optimized in terms of the trade-offs between capital and operating expenditures, and that investments be prioritized and paced in a way that results in predictable and reasonable rates.[51] The long-term financial impact of capitalizing innovation projects could significantly exceed the upfront $15 million amount.

[48] Exhibit 1B, Tab 4, Schedule 2, p. 1
[49] Ibid. pp. 16-17
[50] Interrogatory Response 9-Staff-342
[51] OEB Handbook for Utility Rate Applications, October 13, 2016, p 13

In the most extreme, if Toronto Hydro were to pursue only innovation of a capital nature, the actual expense would be an order of magnitude greater than what is presented in Exhibit 1B.[52] Using the same ratio of capital expense and revenue requirement as provided by Toronto Hydro in other areas of the proceeding, a $15 million "fund" could result in more than $75 million of capital expenditures.

OEB staff also notes that the OEB expects that "any proposal for a rate funded, distributor-owned non-wires solution must demonstrate that a distributor has meaningfully explored contracting services from non-utility owned distributed energy resources (DERs) – including providing sufficient lead time for third-party DER solutions to be identified and implemented – and doing so is either not feasible or less cost-effective."[53]

Toronto Hydro has stated that the proposal is directly linked to the OEB's initiatives relating to non-wires solutions and DERs.[54] OEB staff acknowledges that the non-wires solutions guideline is linked to solutions that can be directly attributed to avoiding "traditional infrastructure investment." Therefore, it is plausible that a custom funding mechanism focused on developing solutions that are not yet ready to deploy at system scale would be appropriate. As such, OEB staff submits it is critical that such a mechanism be clearly distinguished from existing mechanisms. OEB staff further submits that any custom mechanism must be aligned with the principle of pursuing initiatives that obviate capital solutions.

OEB staff submits that a deferral account is the logical mechanism to facilitate such expenditures outside of base rates when other OEB established mechanisms and external funding are insufficient or not applicable.

Eligibility Criteria to Establish a new Deferral or Variance Account

The Electricity Distributors' Deferral and Variance Account Report ("EDDVAR") states that both variance and deferral accounts must meet specific eligibility criteria, including causation, materiality, and prudence. OEB staff submits that Toronto Hydro's proposal to establish a new variance account requires bolstering. OEB staff provides the following in order to support Toronto Hydro.

[52] Through responses to 1B-Staff-12 and JT4.31, Toronto Hydro has demonstrated how approximately $100 million in capital related revenue requirement is driven by over $500 million in capital expenditures in the 2025 to 2029 rate term.
[53] *Non-Wires Solutions Guidelines for Electricity Distributors – EB-2024-0118*, March 28, 2024, p. 11
[54] Exhibit 1B, Tab 4, Schedule 2, p. 7

The causation principle is tenuous because the activities listed as innovation pilot projects, such as grid modernization and integrating new technologies, are activities that a utility would normally be expected to pursue as part of its ongoing operations. Toronto Hydro states that the forecast amount is derived on the basis of it being outside the base revenue requirement and that the projects would therefore not be part that base revenue requirement.[55] OEB staff submits that this is a circular argument predicated on establishing a funding stream distinct from base rates and then identifying work to allocate to those revenues.

OEB staff does note that, separate from Exhibit 1B where Toronto Hydro addresses the causality criteria, Toronto Hydro has provided some additional information regarding the scope of work. Toronto Hydro stated that a key challenge is exploring the feasibility of nascent technologies that are not yet, but expected to be, deployable at the distribution system scale.[56] OEB staff submits that this principle is a reasonable basis to establish causality. It is just that this is absent from the core evidence that addresses the eligibility criteria for establishing a new deferral or variance account. OEB staff submits that if Toronto Hydro is able to demonstrate that the pilot projects fit this definition, then causality is likely to be established.

Regarding materiality, OEB staff notes that $15 Million is material to Toronto Hydro. There is not sufficient evidence on the record to confirm if each project whose costs will be booked in the account will be above the materiality threshold. Regardless, for purposes of a capped innovation fund account, OEB staff accepts the envelope approach to establishing materiality for the purpose of establishing the account. OEB staff reserves the right to argue for a project-based materiality test at the time of disposition.

Materiality is a two-part test that, in addition to considering the monetary amount, also considers the impact to a utility's operations. Toronto Hydro stated that, in some instances it is unsure if certain solutions can be deployed at the scale of a distribution system solution. Toronto Hydro further stated that pilot projects would be an option to develop such a solution to ascertain whether it can be deployed. Toronto Hydro stated that the Innovation Fund is intended to facilitate this. OEB staff submits that this seems reasonable. Therefore, OEB staff submits that the materiality criteria is sufficiently satisfied.

[55] Exhibit 1B, Tab 4, Schedule 2, pp. 16-17
[56] Interrogatory Response 1B-Staff-99, part f)

Toronto Hydro's argument for meeting the prudence criteria is based on the reasonableness of the funding allotment of 0.3% of revenue requirement and the proposed internal governance framework.[57] The funding allotment is based on a jurisdictional review, which, as noted above, shows that all the "comparable" innovation funds were administered either by the regulator or a state department. OEB staff submits that the level of rigor between a committee internal to the utility and that of a regulator is not comparable. OEB staff submits that this disparity fundamentally invalidates the notion that Toronto Hydro's proposal is comparable.

OEB staff submits the argument for the prudence criteria is the weakest. OEB staff submits that the prudence criteria would be met if clear expectations regarding the nature of or criteria for the pilot projects are defined at the outset. The entirely internal governance framework with only project concepts is insufficient.

OEB Staff Recommendations Regarding Toronto Hydro's Proposed Innovation Fund

The following is a summary of the above and OEB staff's submission regarding Toronto Hydro's proposed Innovation Fund, the associated Innovation Fund Rate Rider, and the accompanying Innovation Fund Variance Account. OEB staff has identified several concerns with Toronto Hydro's proposals:

- The proposed pilot projects are only defined as concepts and it is unclear how the work will be, or should be, distinguished from the general improvements that are expected to accompany productivity gains as part of sound utility practice and prudent business operations.
- Toronto Hydro appears to be requesting unlimited flexibility in both capital and operating expenditure with minimal oversight regarding project selection or execution.
- The proposed rate rider is based on an allotment of funds and not a forecast of expenditures; nor is there a firm indication of the planned work.
- The filed evidence insufficiently addresses the eligibility criteria to establish a new variance account.

OEB staff empathizes with the difficulty in designing an independent rate funding mechanism for innovation in an uncertain environment. The fundamental challenge is that Toronto Hydro has not demonstrated that all the funded projects, or rather

[57] Exhibit 1B, Tab 4, Schedule 2, p. 17

"concepts," should not be funded by base rates. Nor has Toronto Hydro demonstrated that the OEB's framework for non-wires solutions or external funding sources are fully inadequate.

Despite disagreeing with the filed proposal, OEB staff is inclined to support Toronto Hydro in formulating a reasonable mechanism to support innovation where no other mechanism exists. In order to address all the aforementioned concerns, OEB staff submits that the following elements, or principles, respond to the need for flexibility for innovation within a framework that applies the prudency and rigor commensurate with a custom funding mechanism:

- A fundamental focus on prudence reviews, in this case focused on project selection and execution
- Timely public reporting on project execution, disclosing milestones, progress, and results
- Ex-post prudence reviews on the funded work should be a pre-requisite to collecting additional revenue from customers
- Only apply to operating expenses that pilot new approaches to support third-party solutions or address distribution system needs

OEB staff submits that a deferral account should be sufficient and that the need for an additional rate rider in the 2025 to 2029 rate term has not been demonstrated.

OEB staff reiterates that this fund should not be used for work that simply is not included in the expenditure plan based on Toronto Hydro's settled revenue requirement. This mechanism must not become a top-up to fund additional work. The work must be truly "developmental" in nature with a demonstrable prospect of "scaling up."

~All of which is respectfully submitted~