14 Carlton Street
Toronto, Ontario
M5B 1K5

Telephone: 416.542.2572
Facsimile: 416.542.2776
rzebrowski@torontohydro.com

toronto hydro corporation

2005 February 28

Hand Delivered

John Zych, Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 26th Floor
Toronto, Ontario
M4P 1E4

Dear Mr. Zych:

Re: RP-2004-0188 - 2006 EDR Proceeding
Reply Submissions of Toronto Hydro–Electric System Limited

In accordance with Procedural Order No. 5, please find enclosed eight (8) printed copies, an electronic copy in Word format, and an electronic copy in PDF format of Toronto Hydro's reply submissions in this proceeding. An electronic copy in Word format has also been sent by email to Mr. Ritchie.

Yours truly,

R. Zebrowski, Vice-President
Regulatory Services

encl.

RP-2004-0188: Electricity Distribution Rates

Reply Submissions of Toronto Hydro–Electric System Limited

Introduction and General Remarks

1. Toronto Hydro reiterates its concerns around the inadequate period allowed by the Board to assess the numerous submissions made by participants in this proceeding. This concern has been exacerbated by the fact that in several instances stakeholders have proposed substantially new filing requirements, rules, or constraints, and thus have considerably broadened the scope of material that needs to be addressed. Toronto Hydro is not aware of any reason why these proposals could not have been raised and addressed much earlier in the process, and their late inclusion is out of step with good faith discussions.
2. In other cases, submissions have been unclear or incomplete.
3. Overall, Toronto Hydro regards these developments as symptomatic of a process that has been unduly rushed.

General Submissions Concerning Comparative Approaches

4. Certain intervenors, notably the School Energy Coalition ("Schools") and Energy Probe, advance proposals that rely on benchmarking, either for direct application in setting 2006 rates, or for future application.
5. For example, Schools advocates a benchmarking approach in the areas of fixed/variable rate proportions, variation in distribution rates and mitigation of distribution rate increases, and CDM incentive mechanisms.
6. Energy Probe suggests a number of variables that could be considered under a benchmarking approach such as rates for defined consumption profiles and 'earned return on invested capital'.
7. Toronto Hydro submits that the proposals from Schools and Energy Probe are premature, conceptually flawed, and impractical. As a consequence, any results produced will be unfair. The Board should dismiss these proposals for these reasons.

8. Toronto Hydro wishes to emphasize that it does not argue with meaningful inter-utility comparisons, made on a fair basis using sound methodology and data. Toronto Hydro is quite prepared to work actively toward these objectives.

9. Toronto Hydro's dispute is with those who propose defective, simplistic mechanisms that are bound to produce flawed and misleading results.

10. For example, Schools proposes arbitrary and mechanistic adjustments to fixed/variable rate proportions based on a simplistic, unadjusted ranking of fixed charge levels for utilities across the province. No attempt is made or suggested to account for significant differences between utilities in terms of their rates status (inclusion of MBRR, pending harmonization etc), or for underlying operational differences. In any case, the proposal is contrary to announced OEB intentions not to make unnecessary changes at this time to fixed/variable rate proportions, and corresponding utility expectations to that effect. It is reasonable to expect that fixed/variable rate proportions across utilities will converge when rates are set based on the updated cost of service and cost allocation studies, which will be available shortly.

11. Similarly, Schools proposes a naïve ranking of rates for certain consumption profiles and rate classes. Again, their approach is conceptually flawed, in that every calculated result is included in establishing the median or benchmark, without recognition of differing rate structures and differing rate status as between utilities, or any form of weighting for utility size or customer numbers. Differences in service quality and operating circumstances are also ignored. Not surprisingly, quick and dirty approaches can be expected to produce quick and dirty results.

12. In summary, these proposals represent naïve benchmarking approaches at their worst. The Board should reject these proposals.

13. Energy Probe openly acknowledges the primitive and inadequate state of the art of benchmarking. It states at its paragraph 36: "For benchmarking to succeed in assisting the Board in its consideration of rates for 2006, additional work is needed. The embryonic evidence presented to date must be supplemented and debated."

14. Under the heading "**Process for Applying Benchmarking for 2006"** Energy Probe suggests that a working group should be formed to address these deficiencies, including such technical issues as 'heteroscedasticity and

multicolinearity', and 'appropriate methods for determining cohorts, such as tree clustering, two-way joining and k-means clustering'

15. After proposing the composition of the group and that 'LDCs should be limited to sectoral representation', Energy Probe goes on to suggest 'When the working group recommendations are presented to the Board, the Board might invite comments so that contentious issues can be identified and various positions argued prior to resolution.'

16. Toronto Hydro reminds Energy Probe that 2006 rate applications are due by July 4, 2005.

17. It is quite apparent that Energy Probe's working group proposal could not be undertaken and completed before 2006 rates are to be implemented, much less filed and analyzed by Board Staff. Toronto Hydro opposes the Energy Probe proposal since it is impractical and if attempted would unduly and irretrievably delay the determination of 2006 rates.

Submissions by Rate Handbook Chapter and Topic

Chapter 1- Introduction

18. At pages 2 through 5 of the submission from Schools, a number of substantial new filing requirements are proposed, as well as the creation of a new category of intervenor.

19. Toronto Hydro submits that these proposals are designed to further the unnecessary and undesirable development of a parallel regulatory process in which self-appointed interest groups seek to act as auxiliary regulators.

20. Toronto Hydro is quite prepared to act in accordance with directions from the Board and believes that no deficiency in access to information currently exists for the Schools proposals to remedy. Toronto Hydro rejects the concept of extending special treatment to Schools or any other intervenor, as Schools recently requested in connection with the 2005 rates applications.

21. Schools suggests that new requirements be added to the EDRH to compel utilities "to co-operate with their (i.e., intervenor) participation as long as it is reasonable and does not generate material unnecessary costs to the applicant" (para. 12). Toronto Hydro submits that it and other utilities do cooperate with intervenors in accordance with Board

directions. Toronto Hydro advises the Board that Toronto Hydro will not become embroiled in disputes with intervenors as to what is 'reasonable' and what constitutes 'material unnecessary costs'. The Board should reject this suggestion from Schools because it is vague, unnecessary, and likely to create undue controversy.

22. Toronto Hydro recognizes and accepts that, aside from any confidential matters, its filings with the Board are on the public record. However, to the extent that the Board directs distribution to intervenors of 'live' versions of spreadsheets, Toronto Hydro advises the Board that it cannot be responsible to answer for any derivative material created by intervenors based on Toronto Hydro submissions. Furthermore, Toronto Hydro submits that the Board must direct that intervenors not attempt to file or make public any alternative versions of utility filings that could reasonably be mistaken for material originated and submitted by utilities. Any 'live' versions of spreadsheets should be locked (i.e., 'read-only') so that the internal logic is apparent but nothing in the spreadsheets themselves can be altered or tampered with.

Chapter 3 – Test Year and Adjustments

Section 3.0 – Test Year and Adjustments (Disclosure of 2006 events)

23. Several intervenors take the view that utilities filing historical test year applications should nevertheless be required to disclose material events expected to occur in 2006.

24. For example, Schools states at paragraphs 15 and 16
"Those who oppose this disclosure are in effect proposing that the Board establish just and reasonable rates without all the material facts"; and
"there is today a general obligation on every applicant before the Board to disclose to the Board all facts in the applicant's possession that are material and are relevant to the setting of just and reasonable rates."

25. First, Toronto Hydro observes that disclosure would be pointless if the Board were precluded from acting (i.e., setting 2006 rates) in part on the basis of the disclosed 2006 information. However, if the Board does act on the basis of that information, the historical year approach is departed from.

26. Taken together, these statements really amount to stating that the Board should set rates on the basis of the best available information. Therefore, Toronto Hydro is puzzled to observe that in other areas intervenors demand that no allowance be made for costs that are expected in 2006 but don't appear in 2004.

27. The simple fact is that the historical test year approach is at best a proxy that was initiated by Board Staff to reduce the workload for Staff and stakeholders in processing the 2006 rate applications. Many utilities may be prepared to file historical test year applications if they can be confident that that approach will not be systematically biased against them through permitting some adjustments and not others.

28. As it stands however, the prospect may appear to be that under historical applications, utilities will be permitted to recover the lower of their historical costs or their 2006 costs in each identified category. Together with the fact that the draft EDRH limits Tier 1 adjustments, this may effectively force several utilities to file forward test year applications.

29. The 'regulatory bargain' involved in an historical test year needs to be balanced or it is no bargain. If the Board directs disclosure of material events in 2006 for historical applications, it must be prepared to accept all material events. However, such an approach would substantially erode the simplicity benefits of an historical approach. Furthermore, as stated in Toronto Hydro argument, this section of the handbook is too vague at present to be actionable by utilities.

Section 3.2 – Test Year Adjustments

Smart Meters and CDM

30. Certain intervenors take the view that CDM investments ought not to be allowed in utility ratebase, "since those amounts have been paid for in full by the third tranche" [of MBRR].

31. First, this position is directly contrary to the expressed intention of the Minister of Energy, who stated in his letter of May 31, 2004 to utilities "Conservation assets should be included in the rate base." The Board itself cited this quotation in its RP-2004-0203 Decision with respect to the CLD CDM applications, and confirmed that CDM assets would be included in ratebase.

32. Second, several intervenors fail to appreciate that by definition, MBRR constitutes utility earnings, not utility expenses. It would be particularly

unreasonable, given the situation and objectives of the Province, to propose that utilities not be able to reinvest their own earnings in CDM projects. Any investment made by utilities, in CDM or any other area, and found by the Board to be prudent, should certainly be permitted in ratebase.

Chapter 4 – Rate Base

Section 4.1 –Rate Base Measurement Date

33. Certain intervenors such as Schools and LPMA urge the use of an average figure for 2004 ratebase as the most appropriate proxy for 2006 ratebase. Schools asserts that an average ratebase figure is consistent with the volumes 'it was generating'. LPMA states that using year end ratebase figures will create a 'phantom return on equity'.

34. Toronto Hydro rejects both of these concepts, which arise from fundamental misunderstandings of utility operations and the rate setting process.

35. For utilities filing historical test year applications, 2004 year-end ratebase will in any case provide the best estimate of 2006 ratebase. Whether a utility's ratebase is assumed to be declining, static, or growing in the 2004-2006 period, a figure further removed in time cannot produce a closer estimate of 2006 values.

36. Schools proposes that ratebase produces volumes. While there is a rough positive relationship between distribution plant and volumes over the long term, ratebase does not generate volume. Demand generates volume. In addition, in cases where utilities are replacing plant at the end of its useful life, ratebase can grow without any increase in volume. The relationship between ratebase and volume is far too weak to justify setting ratebase and volume proxies on the same basis.

37. LPMA apparently fails to realize that the rate year in question is 2006, not 2004. Setting aside depreciation, which can be analyzed separately, the simple fact is that plant that was put in place by year-end 2004 will be in place, and will remain in place for 2006. Using the 2004 proxy for 2006 is not equivalent to forecasting capital additions occurring in 2006 and ratebase levels for 2006, prior to that year.

38. Toronto Hydro notes that LPMA has no difficulties using year-end figures for customer count, as is emphasized at page 29 of its submission.

39. Toronto Hydro submits that it is clear that 2004 year-end figures for ratebase will produce better estimates of the 2006 values, and that the Board should dismiss other proposals that create a larger lag between 2006 actual and proxy values.

Section 4.3 Capital Investments

40. Toronto Hydro supports alternative 2, on the basis that it depends simply on a percentage of net fixed assets and therefore would apply uniformly across utilities.

41. Using the assumption that the Working Capital Allowance represents about one sixth of ratebase, Toronto Hydro observes that under Alternative 1, the fixed materiality thresholds always govern, except when ratebase is less than $45 Million. (This calculation is based on multiplying ratebase by 5/6*0.2% to obtain the variable materiality threshold as a function of Net Fixed Assets.) In effect, Alternative 1 as stated becomes a proposal to use a coarse step function to determine materiality thresholds.

42. Toronto Hydro is not persuaded by any evidence or submissions that such an approach is fairer or otherwise superior to a simple proportional approach, as outlined in Alternative 2.

Chapter 5 – Cost of Capital

Section 5.2 – Debt Rate

43. Certain intervenors have raised concerns around the motivations of municipalities that are both shareholders and debt holders. For greater certainty, Toronto Hydro submits that the EDRH should clarify that when debt is issued externally by a utility parent (not the municipal shareholder) *on behalf of the utility*, (e.g., in circumstances when the utility itself is not a rated entity), the debt rate that should apply should be the actual debt rate payable by the utility. In this circumstance, the Board and stakeholders can verify the dedication of the external debt to utility purposes by reference to the documents that accompany the issuance of the debt. This clarification is particularly pertinent since over the next several years, municipal debt holdings are required to be monetized.

Section 5.4 – Working Capital Allowance

44. LPMA asserts that forecasts of the cost of power should be avoided as this would be 'dangerously close to a forward test year process'. Toronto Hydro rejects this position as it seems to imply that 2006 costs of power are what are under scrutiny in this process.

45. It is unreasonable to suggest that the Board not recognize the potential for significant increases in the cost of power that utilities must finance, even aside from volume fluctuations. The Board itself is engaged in a cost of power forecasting exercise in connection with the RPP. Toronto Hydro submits that it would be unfair and unnecessary to systematically understate (or overstate) the cost of working capital related to the cost of power by ignoring reasonably anticipated changes in price levels.

Chapter 6 – Distribution Expenses

Section 6.2.5 – Employee Total Compensation – incentive plans

46. Several intervenors have placed great emphasis on disallowing costs for employee incentive programs that are said to benefit shareholders. Toronto Hydro questions both the conceptual and the practical basis for making such distinctions, and submits that the Board should exercise great caution in categorizing incentive plan expenses as non-recoverable in rates.

47. Conceptually, Toronto Hydro is yet to be convinced that a clear distinction can be made between performance goals such that some are categorized as being to the benefit of shareholders only. Typically, the suggestion is that an earnings target is to the benefit of shareholders and not ratepayers. However, it would be very difficult in any particular case to conclude based on isolated or partial information that ratepayers do not benefit from earnings, since earnings are a prime source of funds for re-investment in a distribution system.

48. In addition, under the former PBR regime, utilities were given incentives to increase earnings. Earnings sharing mechanisms have often been featured in such systems, so that ratepayers benefit directly, and upon rebasing, the cost savings that have improved earnings are incorporated into rates.

49. Furthermore, a target involving earnings may involve nothing more than achieving the allowed rate of return. Given that the Board expressly

authorizes that rate of return and sets rates to provide utilities with the opportunity (but not a guarantee) to earn that rate of return, it is difficult to rationalize disallowing the expenses associated with that target. Therefore, the Board would be faced with having to more specifically state what kinds or levels of earnings are considered objectionable.

50. In addition, the practical implementation of such a system would necessarily involve the Board in highly questionable and minute calculations in the case of every utility that it discerned had a potentially disallowable component of incentive compensation.

51. Toronto Hydro submits that the proposition that some incentive plan costs should be disallowed on the basis that the benefits somehow flow only to the shareholder is vague, conceptually flawed, and not possible to implement in a fair manner without involving the Board in undue micro-management. The Board should dismiss this proposal.

Chapter 7 – Taxes / PILs

Section 7.1.2.2 – Non-recoverable and Disallowed Expenses

52. Toronto Hydro supports and relies upon the reply submission of the Coalition of Issue Three Distributors.

53. Several intervenors have advanced propositions to the effect that the Board should take into consideration provincial tax policy, which policy is beyond the Board's jurisdiction, as to the disposition of PILs payments. Some suggest that the PILs system in Ontario is not normal, and that in fact the PILs system 'is essentially closed' (LPMA, page 23), with the result that the Board must take notice of and adjust its rulings based on how the province (currently) collects and disposes of its tax revenues.

54. Toronto Hydro submits that these propositions are specious and should be entirely dismissed by the Board.

55. LPMA asserts that any reduction of PILs payments by utilities represents a foregone opportunity to reduce the Ontario Hydro residual stranded debt burden to the benefit of electricity ratepayers. On LPMA's reasoning, utility PILs payments should be maximized so that the stranded debt could be paid off sooner. However, LPMA contradicts itself by earlier stating (at page 20) that utilities should be 'required' to take prudent steps to 'manage' i.e., reduce their tax costs.

56. Furthermore, on that same reasoning, utility earnings and the applicable tax rates should certainly be dramatically increased so that their PILs payments would also increase.

57. These implications of the position advanced by LPMA and others clearly show the fallacy in that line of reasoning. In the case of expenses that are disallowed in rates by the Board, by definition the costs are funded from utility earnings. The fact that the province allows an expense to be deductible for tax purposes is a matter of provincial tax policy, not electricity ratemaking, since at root it is a matter of the disposition of utility earnings, not the level of utility expenses allowed in rates. It is not, and should not be, part of the Board's concern or jurisdiction to defeat the intention of the province when it allows certain expenses to be deducted for income tax purposes.

58. The simple fact that the province chooses to devote PILs payments to the retirement of the stranded debt is actually separate and independent of electricity ratemaking. It would be irrelevant for any other observer to criticize the fact that PILs payments were directed to the stranded debt rather than healthcare or transportation infrastructure. It would be similarly misguided to suggest that a given employee be paid less if she invests in an RRSP, since her taxes will be lower as a result.

59. The argument of LPMA and others that PILs, the Debt Retirement Charge, and electricity rates are a 'closed system' is fallacious and the Board should reject it.

Chapter 8 – Revenue Requirements

Section 8.3 – CDM, Smart Meter, and Regulatory Asset Amortization Revenue Requirements

60. Energy Probe asserts without reasons (page 11) that CDM and Smart Meter assets should be segregated in 'regulatory asset' accounts.

61. Toronto Hydro does not object to specific tracking of these assets, but rejects the concept that they should be relegated to 'regulatory asset' accounts. Toronto Hydro understands the term 'regulatory asset' to imply that recovery and return are contingent. Energy Probe has produced no reasons whatsoever to treat these assets in that manner.

Chapter 10 – Rates and Charges

Section 10.1 – Fixed/Variable Split

62. The draft EDRH states, without alternatives, that the 2004 proportions of fixed and variable charges should be maintained for 2006, absent a specific justification in a particular application to change the proportions.

63. However, Schools asserts that the proportions should be those of 2005, since the Board altered those proportions in the 2005 RAM.

64. Toronto Hydro objected in its 2005 rate application to this change, made without consultation and, to the knowledge of Toronto Hydro, without evidence. Furthermore, the consensus position stated in the draft EDRH was clearly made in reference to the 2004 proportions, and this issue was not identified as unresolved. Had it been, Toronto Hydro would have made submissions regarding this in the hearing.

65. In addition, Schools now makes further proposals to arbitrarily adjust the fixed charges of certain distributors in advance of the cost allocation study results. Since the variation in fixed charges was widely known even prior to the commencement of the EDR process, Toronto Hydro knows of no reason why Schools could not have raised its concerns in the working group process leading up to the preparation of the draft EDRH. Again, had this issue been declared as unresolved, Toronto Hydro would have made submissions during the hearing.

66. Therefore, Toronto Hydro submits that it would be improper and unfair for the Board now to accept the Schools proposals in these matters. In raising these proposals at the last minute in the manner that it has, Schools has departed from the spirit and the process of consensus building that the EDR process has been founded on.

Section 10.5 - Update of Loss Adjustment Factor Reflecting System Losses including Unaccounted-for Energy

67. LPMA asserts that variances in losses from an average value should be totally to the account of the shareholder. This position is offered as an opinion and is not supported by any evidence.

68. Toronto Hydro submits that LPMA's proposal could and should have been made known to stakeholders during the working group process, and duly recorded as an alternative if consensus was not achieved. Given that it was not, Toronto Hydro submits that the Board does not

have the required evidentiary basis to make very substantial changes to the treatment of losses, which evidence would for example include the causes of losses, the technical scope for loss reductions, and the impacts on utility risk profiles of any proposed changes. Therefore, the Board should reject LPMA's proposal.

69. Toronto Hydro reiterates that losses are difficult to quantify precisely on an overall basis, since they are residual amounts that cannot be directly observed or measured but must be derived after making estimates of changes in unbilled revenue amounts and consumption by unmetered uses. Furthermore, losses are a non-linear function of current flow, and current is significantly affected by factors completely outside the control or influence of utilities such as weather. Therefore, it is more constructive for utilities to focus on specific, well-understood and quantified loss reduction programs as part of CDM, than for utilities to be placed at significant financial risk around something that is largely determined externally.

Chapter 13 – Mitigation

Section 13.2 – Mitigation Methodologies

70. Schools proposes that the Board engage in a two-stage exercise of benchmarking rates: first for 2005, and subsequently for 2006. After the Board approves 2005 rates, Schools would have it publish costs for various consumption profiles under all approved utility rate schedules.

71. In making their 2006 rate applications, utilities for which costs vary by more than an arbitrary amount from an unadjusted average would be subject to additional filing requirements that, in essence, demand that utilities explain not only their own rates, but the rates of all other utilities included in the calculation of the unadjusted average.

72. Toronto Hydro opposes the proposal from Schools that the Board compile and publish crude and unadjusted rate comparisons, in part for the very reasons that Schools itself acknowledges.

73. The Schools proposal is yet another crude attempt at benchmarking based on incomplete data and faulty assumptions. Furthermore, its very premise is that 2005 Board-approved rates are unjust and unreasonable, simply because rates vary between utilities. Schools poses the question:

"How can rates be just and reasonable when there exist such wide variations, many of which cannot be explained by external factors?"

74. The simple fact is, Schools does not know what proportion of the variation is explained by external factors. While it acknowledges that the external factors exist and are relevant, its proposal does nothing to even attempt to account for them. Instead, Schools puts the onus on the Board by stating that "the Board should prepare an explanation of the various reasons why rates can differ from one area to the next, and a caution that the raw data comparison is only a starting point to a review of the reasons for the disparities".

75. Toronto Hydro submits that the Schools proposal is irresponsible, since Schools acknowledges that the publication of data by the Board in the form Schools suggests would have to be remedied by the Board itself. The crude comparison proposed by Schools does not account for any of the factors (cost drivers) agreed upon by the Comparators and Cohorts working group, or by the Board's own C&C witness. It also does not account at all for the whole dimension of service quality. Put simply, it does not identify or clarify any distinct issue that should be of concern to the Board; rather, it confuses and muddles the issues, and does nothing to isolate cases of inefficiency or inadequate utility performance.

76. Toronto Hydro fails to see how the publication proposal or any of the derivative proposals could be helpful to the Board or to the public. The Board should reject the Schools proposals for 'mitigation'.

Chapter 14 – Comparators and Cohorts

Section 14.1 – Methodology

77. Toronto Hydro refers to and relies on its earlier submissions in this document appearing under the heading "General Submissions Concerning Comparative Approaches".

78. Energy Probe suggests that the title of this chapter be changed to "Benchmarking', on the basis that the Comparators and Cohorts approach is said to be a subset of benchmarking.

79. Toronto Hydro does not consider this suggestion to be merely semantic. Indeed, one of the central issues in this area is the use to which any methodology might be put, and specifically whether any approach would be limited to screening or would in fact extend to ratemaking.

80. The Board has clearly stated that for 2006 rates the use of Comparators and Cohorts will be limited to screening. Furthermore, the draft EDRH is itself confined to the 2006 rate year. Therefore, Toronto Hydro submits that it is inappropriate to widen the scope of Chapter 14 to 'benchmarking'.

81. The CCC has devised three tests of the C&C system, which are set out here for convenience of reference:

    a. Is the mechanism fair to LDCs, in the sense that they are all treated in the same way and in the sense that they can obtain the data at reasonable cost? With respect to this latter point, the Council needs to be assured that employing the C&C mechanism will not impose an undue burden, particularly on smaller and less sophisticated LDCs.

    b. Is the mechanism reasonably accurate, that is, does it reflect the actual circumstances of the LDCs?

    c. Will the mechanism be used as a screening tool only, that is, not as a tool which is determinative of their rates? As a corollary, will the LDCs have a full opportunity to explain any anomalies which the mechanism identifies in their applications?

82. The CCC goes on to state "The Council is satisfied from Mr. Camfield's cross-examination that the C&C mechanism meets all of its tests and should, therefore, be employed."

83. Toronto Hydro has concerns that CCC's conclusions may be premature, since according to testimony from Mr. Camfield quoted by CCC at page 8 of their submission, there are items integral to the mechanism "which "largely relate to design specification, which is part of our task in this year, calendar year 2005…" ". It would appear that the mechanism in question has not been fully specified, and this conclusion is consistent with Mr. Camfield's representation of his work as a 'proof of concept'. If the mechanism has not been specified, it is doubtful that CCC's tests can be properly applied.

84. CCC's first test is not sufficient to determine fairness, since all LDCs could be treated equally under an unfair mechanism.

85. In the case of CCC's second test, it is reasonable to generally assume that data submitted by individual LDCs accurately represents their circumstances. However, it has not been established that any mechanism relying on non-comparable data will produce an accurate representation of circumstances <u>across</u> LDCs.

86. With respect to the first part of the third test, the Board itself has committed to using any C&C mechanism for screening purposes only in 2006. However, in Toronto Hydro's view, it is beyond Mr. Camfield's authority to give assurances that utilities will be given a full opportunity to explain 'anomalies'.

87. Toronto Hydro submits that while utilities should certainly be given a full and fair opportunity to explain, as necessary, any features of their applications, it would be unreasonable to expect that individual utilities could give a quantitative explanation of an average or other reference point by which an 'anomaly' is defined. By construction, the reference point would have to be a function of the data of other utilities, which an applicant would not be privy to and which an applicant is not responsible for. Therefore, while applicants may be able to identify areas of cost differences and reasons for those differences, there should be no expectation that an applicant can independently explain or quantify the degree to which those costs are 'anomalous'. That would necessarily require an explanation of the reference point that no individual utility would be able to provide.

Conservation and Demand Management

CDM Consultatives

88. Intervenors including Schools and GEC make elaborate proposals concerning requirements for 2006 CDM filings, a CDM stakeholder consultative, extended filing deadlines, establishment of CDM budgets, and other matters.

89. Toronto Hydro submits that few utilities will be positioned to file CDM plans that are incremental to their 'Phase 1' (i.e., MBRR-funded) plans, which themselves cover the period 2005 to 2007. Utilities with approved Phase 1 plans are, and should be, focusing on implementing those plans, rather than diverting resources to devise incremental i.e., Phase 2 plans. Given the magnitude of the MBRR funding, most utilities should be able to maintain meaningful and substantial CDM activity over the 2005 to 2007 period.

90. Despite the establishment of the OPA Conservation Secretariat, Schools asserts the need for a CDM Consultative. Yet according Schools, 'There is a great deal of information currently out there, so this work does not need to be done from scratch'.

91. Schools makes no mention of a budget for such a consultative, or even how members of a consultative would be established. Schools only mentions in passing that 'Funding for the consultative should be part of the costs process for the 2006 rates, to simplify the administrative details.' Toronto Hydro must assume therefore that Schools intends that any intervenor can self-appoint to the consultative, and simply submit a bill after the fact without any assessment of their contribution to this extra-hearing process.

92. GEC submits that a consultative group be selected by the Board, with their time and expenses paid by the Board and charged to utilities (and by extension utility customers). Although GEC uses the term 'Advisory Committee', it is clear that they seek to establish an auxiliary regulator that would act as a gatekeeper and screen utility proposals before submitting its own recommendations to the Board. Similar to Schools, GEC proposes no membership criteria, budget, or performance standards for its advisory board. The composition of the advisory would almost certainly be controversial initially, and would have a very high potential to be controversial on an ongoing basis.

93. Toronto Hydro submits that it would be costly, diverting, and redundant to establish yet another body, funded by ratepayers, to undertake yet another roundtable discussion of CDM issues. It is clear from the history of such groups that stakeholder positions are entrenched, and 'consensus' can only be reached by limiting participation to sub-groups with like views.

94. Toronto Hydro submits that for the 2006 rate year, very few utilities are likely to avail themselves of any part of the (potential) output of such a group, assuming that the group would actually produce anything above and beyond what the Board and/or the OPA could determine themselves. Therefore, Toronto Hydro recommends that the Board not establish any such group(s).

LRAM Mechanisms and Revenue Protection

95. It is apparent that opinion on LRAM mechanisms differs widely. Toronto Hydro has already submitted in argument that it favours a simple, sensible approach to revenue protection for utilities, to remove the financial penalty resulting from load loss. At this time, when utility CDM programs are being initially implemented, Toronto Hydro does not see the necessity or benefit of complex lost revenue determination schemes.

96. In the future however, there is a risk that as CDM load impacts become larger, there will be increased controversy around the precise quantification of CDM load impacts. Overall, the use of LRAM mechanisms is likely to cause increasing costs and regulatory burden for the Board, utilities, and intervenors. In addition, the magnitude of retroactive price adjustments for customers will grow. For these reasons, Toronto Hydro recommends that LRAMs be regarded as transitional measures.

97. In the longer term, it is appropriate to reduce the mismatched recovery of fixed costs through variable charges, and move toward higher fixed charges for distribution services. This will naturally remove the significant lost revenue disincentive faced by utilities, which disincentive is artificially created to begin with due to the practice of recovering fixed costs through variable rates.

98. Toronto Hydro notes and supports the proposal made by Woodstock Hydro Services to pilot the use of increased or fully fixed charges for distribution services, and furthermore notes that a sound basis for developing fixed charge design should be available after the completion of the cost allocation studies. This presents a practical timeline for progressing toward a fixed charge system.

99. Toronto Hydro acknowledges that it is dogma within some quarters that any lowering of variable charges should be resisted in order to maximize the price incentive for conservation. However, Toronto Hydro does not support artificial distortion of prices to achieve a given end, especially when such distortion is not necessary. Even under a 100% fixed distribution charge system, the majority of customer electricity costs will be driven by variable consumption charges.

100. Despite academic arguments around long run marginal costs, the simple truth is that the vast majority of the province is already served with distribution infrastructure, the costs of which are fixed. New infrastructure costs (e.g., for new subdivisions) may in some degree be tempered by gradually decreasing peak capacity requirements, but are nonetheless primarily driven by customer count. After distribution plant is in place, the associated infrastructure costs are essentially invariant to fluctuations in load within rated capacities.

101. Therefore, for year-to-year rate setting purposes, the costs of distribution infrastructure should not be treated as if they varied with levels of energy consumption. It follows that distribution service rates should also not depend significantly on variable consumption levels.

SSM Mechanisms

102. Again in the case of corporate incentive mechanisms for CDM, Toronto Hydro urges the Board not to assume that its determination for 2006 must be the last word. As with LRAMs, Toronto Hydro believes it is reasonable and effective to start with a simple and sensible mechanism, and introduce greater degrees of sophistication as experience and circumstances warrant.

103. An SSM designed as a proportion of TRC net benefits is a reasonable place to start. Toronto Hydro emphasizes that such a mechanism would only reward utility performance that benefits ratepayers. Certain intervenors suggest that producing net benefits is as easy as falling down: that it is virtually inevitable given any level of spending on CDM programs.

104. It is more reasonable to suppose that producing CDM net benefits requires time, resources, and effort on the part of utilities. Furthermore, all reasonable observers agree on the need for positive incentives. Therefore, Toronto Hydro submits that the Board should begin by adopting a simple linear SSM that rewards utilities for producing documented net benefits.

105. Schools asserts that such a mechanism would reward insipid results, and suggests instead a contest between utilities. However, the race that Schools suggests would have no visible finish line, would pit utility against utility to the detriment of cooperation and sharing of successes, would penalize one utility for the success of another, and would base judgement of success on flawed criteria that ignore specific directives from the Board.

106. Schools first criterion is "Total volumes saved as a ratio of base year volumes". This criterion expressly ignores cost effectiveness, as well as differences in CDM potential between utilities with different customer and end-use compositions. In addition, it is narrow, since it does not account at all for other important objectives of CDM programs such as broad-based access to programs.

107. Schools second criterion is "TRC Benefits as a ratio of C&DM budget spent". This criterion would expressly encourage utilities to pluck low hanging fruit while avoiding investments and efforts with higher total benefits but lower (though still positive) TRC ratios.

108. Worst of all, by way of its simplistic and cynical benchmarking approach, Schools proposal would make one utility's success a setback to another.

Toronto Hydro submits that this is entirely unwarranted, and that the Board should reject the Schools SSM proposition.

Separation of Phase 1 and Phase 2 CDM Programs

109. For clarity, Toronto Hydro uses the term 'Phase 1' to refer to the MBRR-funded, Board-approved utility CDM programs in effect over the period 2005-2007. 'Phase 2' refers to programs yet to be proposed, which involve further expenditures and investments, incremental to those already underway in Phase 1.

110. Toronto Hydro urges the Board to maintain a clear separation between these different Phases. The unique origin and ratemaking treatment of Phase 1 programs distinguishes them from further programs that can be expected in the future. After the fact changes in regulatory treatment of Phase 1 programs should not be allowed, since such changes would undermine or contradict Board Decisions that have already been issued.

111. As an example of a proposal which should be modified or rejected outright, at page 28 of its submissions, VECC states that [the Board should] "Require that all 2006 expenditures that are included in the 2006 Revenue Requirement (Residual 3rd tranche and new money) must pass both the TRC Test and on a sectoral basis, the RIM test."

112. Toronto Hydro urges the Board to clarify that there will be no 'Residual 3rd tranche' CDM expenditures in the 2006 revenue requirement. Funding of Phase 1 programs will have come from the 2005 MBRR amounts. Various utilities will by that time have made CDM investments that should be reflected in the 2006 ratebase, and these increments to ratebase should be treated in the same fashion as any other ratebase item; i.e., attract amounts of revenue requirement for return, depreciation, and taxes. However, beyond that standard treatment of ratebase items, there will be no continuing recovery of Phase 1 CDM expenses in 2006 or afterward.

113. Nevertheless, the Phase 1 programs will continue in 2006 and 2007. Toronto Hydro submits that it would be improper and unfair to change the established regulatory treatment and requirements for those Phase 1 programs by making them subject to the same requirements (yet to be determined) as Phase 2 programs, which the VECC proposal cited above would do. Therefore, the VECC proposal should be revised to exclude reference to Phase 1 programs and expenditures, or simply be rejected entirely.