



EB-2009-0243

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

AND IN THE MATTER OF an application by Toronto Hydro-
Electric System Limited for an order approving just and
reasonable rates to be effective May 1, 2010.

BEFORE: **Paul Vlahos**
Presiding Member

DECISION
(Corrected)

December 11, 2009

INTRODUCTION

Toronto Hydro-Electric System Limited (“THESL” or the “Applicant”) filed an application with the Ontario Energy Board (the “Board”) on June 30, 2009, under section 78 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c.15 (Schedule B), seeking approval for changes to the rates that THESL charges for electricity distribution, to be effective May 1, 2010. The Board assigned the application File No. EB-2009-0243 (the “Application”).

In the Application, it is requested that the Board approve rate riders to recover costs incurred by THESL for the emergency correction of contact voltage conditions on its system, mainly incurred from February through March of 2009.

The Board issued a Notice of Application and Hearing dated July 17, 2009. The Vulnerable Energy Consumers Coalition (“VECC”), the School Energy Coalition (“SEC”), Energy Probe Research Foundation (“Energy Probe”) and the Canadian Union of Public Employees, Local One (“CUPE One”) were approved as intervenors and, with the exception of CUPE One, were found eligible for an award of costs.

Procedural Order No. 1 was issued on August 19, 2009. The Board made provision for written interrogatories and for submissions. The Board stated that it intended to proceed by way of written hearing in this matter, but might include an oral component if in the Board’s view it was warranted, with this determination to be made at a later stage.

Procedural Order No. 2 was issued on September 28, 2009. The Board stated that it had reviewed the responses to the interrogatories provided by THESL and determined that it would proceed by way of an oral hearing to allow for further clarification of the responses by THESL to the interrogatories. A one-day oral hearing was held on October 8, 2009.

Final submissions were received from all intervenors and Board Staff on October 22, 2009. THESL filed its reply submission on November 5, 2009.

In this Decision, the Panel summarizes the evidence and submissions only to the extent necessary to provide context to its findings. The full record is available at the Board’s offices.

THE APPLICATION

THESL applied to recover through rates certain costs incurred by THESL arising from the emergency correction of contact voltage occurrences on its electricity distribution system (the “Level III Emergency,” or the “contact voltage emergency” or the “emergency”). The costs were incurred from February through March of 2009, although one category would be continued to year end 2009. According to THESL, the costs incurred were unforeseen and incremental to its existing Board-approved revenue requirement. THESL further stated that the application was brought to demonstrate that the costs in question met the eligibility requirements of the Board (Incrementality, Exogeneity, Materiality and Prudence) pertaining to “Z-factor” type costs and that the recovery of these costs through rates would be proper.

The contact voltage correction costs for which THESL sought recovery are summarized in the table below.

Cost Description	Expenditure (millions)
Scanning Costs	
Level III Emergency Scanning Costs	\$ 4.15
Continued Scanning Expenditures	2.41
Total Scanning Costs	\$ 6.56
Level III Emergency Remediation Costs	
Labour – Regular time	\$ 3.37
Labour – Overtime	2.15
Electrical Contractor Cost	0.67
Inventory and Materials	1.01
Other	0.59
Total Level III Emergency Remediation Costs	\$ 7.79
Total Contact Voltage Expenditures	\$ 14.35

The \$14.35 million of incremental costs for which THESL sought recovery was segregated into two categories: scanning costs and remediation costs.

Scanning costs represented \$6.56 million of the \$14.35 million total. THESL proposed that, as the scanning costs were undertaken to ensure the safety of the entire distribution system and as an operational matter could not and should not have been confined to a particular class or classes of customers, these costs be allocated to all customers based on the methodology embodied in the Board's cost allocation model using customer numbers. THESL noted that this resulted in the large majority of these costs (86%) being allocated to Residential and small General Service customers, with substantially all of the remainder being allocated to the Streetlighting and USL classes.

The remaining balance of \$7.79 million related to the remediation of contact voltages and inspection and remediation of handwells. THESL proposed that these costs be recovered from the Streetlighting and USL rate classes only in proportion to the number of connections in those rate classes. THESL submitted that a strictly accurate determination of the allocation of remediation costs was not possible in the situation, but its proposal produced a reasonable outcome.

The results of THESL's proposals would allocate the \$14.35 million requested relief as follows: \$5.071 million for the Residential class, \$0.549 million for the General Service less than 50 kW class, \$7.126 million for the Streetlighting class, \$1.576 million for the USL class and lesser amounts for the remaining classes.

THESL proposed that the recovery of amounts allocated to classes other than Streetlighting and USL be recovered over 12 months commencing May 1, 2010 by way of rate riders calculated as fixed monthly amounts per customer as applicable. For the USL and Streetlighting classes, THESL proposed that in view of the significant bill impacts involved, the costs should be recovered over three years.

BOARD FINDINGS

On the contents of the Application and the submissions of the parties, the Panel has determined that the issues it needs to address are as follows:

1. Is the relief requested of a Z factor type?
2. Are the expenditures material?
3. Was the emergency caused by exogenous factors?

4. Are the expenditures incremental?
5. What cost amounts are eligible for recovery?
6. How should the costs be allocated and recovered?

In setting out its findings, the Panel has also referenced parties' submissions but only to the degree necessary to provide context to its findings.

Is the relief requested of a Z factor type?

As THESL's 2009 rates were set under a cost of service review, the first issue requiring Panel consideration is the application for relief as a Z factor. This was seen by some as a threshold issue.

SEC and VECC argued that THESL is neither entitled to apply for Z factor relief in accordance with the July 2008 *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* (the "3GIRM Report") nor has it met the threshold burden of proof required under cost of service regulation.

VECC noted that THESL could apply to the Board for relief under exceptional circumstances, such as financial distress, but these have not been demonstrated in this case. If the Board is persuaded that THESL may be entitled to consideration of its application, such consideration should be deferred, and in the interim THESL should be directed to track the costs in a deferral account.

SEC noted that while a utility can ask for a rate adjustment at any time and for any reason, in practice the Board establishes rules and guidelines to make the regulatory process manageable and predictable and the Board follows those rules and guidelines unless in an individual application there are special circumstances that warrant a departure. THESL's application, viewed either as a Z factor or in the context of account 1572 (Extraordinary Event Costs), was seen by SEC as ill-founded and should not be accepted.

Staff noted that regardless of whether this application was filed under the authority of the Board's 3GIRM Report and the related Z factor provisions, or whether THESL

simply requested the disposition of an amount in deferral account 1572, the tests applied in the examination of the validity of these costs would be generally the same.

The Panel agrees generally with THESL that the procedural distinctions made by SEC and VECC are too technical in nature, and not of substance. A distributor has the legal right to bring an application to the Board for what it may consider to be extraordinary circumstances. A cost of service regime cannot bar a distributor from bringing applications for relief for what it considers to be a genuinely extraordinary event. The fact that the Board has not specifically enunciated the circumstances and criteria that would apply for distributors under a cost of service regime as it has done for an IRM regime, does not mean that the application brought by THESL should fail outright. Rather, the issue for the Panel is what should be the standards or criteria for assessing THESL's requested relief.

This is a unique application in two respects. First, it seeks relief for a very unusual, surprising event in the history of the Applicant's distribution system and in the history of electricity distributors in the Province. Second, the Application is grounded on stipulated Z factor criteria reserved for an IRM regime, yet the Applicant is under cost of service. THESL fashioned and supported its application as a Z factor using the Board-stipulated criteria of materiality, exogeneity, incrementality, and prudence that apply to Z factor applications under the IRM regime. In that regard, it argued that its application for relief should be "ring-fenced" from the revenue requirement aspects pertaining to the 2009 rate year already ruled on by the Board in a cost of service proceeding.

In the Panel's view, assessment of the relief sought on the basis of the Z factor criteria enunciated in the 3GIRM Report can be applicable to the relief sought in this case as the Applicant has done. However, the Panel does not accept THESL's position that all aspects of the 2009 revenue requirement previously approved by the Board should be "ring-fenced". To the extent that actual expenditures in 2009 are below the level underpinning 2009 rates, this should also be a consideration for determining any eligible relief for the emergency expenditures made; otherwise, there is a possibility that the shareholder would be unfairly enriched by any relief provided.

Are the expenditures material?

The Board's most recent materiality thresholds for different sized distributors appear in the Board's 3GIRM Report. The threshold is set at \$1 million for distributors with a

distribution revenue requirement of more than \$200 million, which is the group under which THESL falls. The cost claim of \$14.35 million related to the Level III emergency meets the Board's materiality criterion, as enunciated in the 3GIRM Report. There is no basis to suggest that the materiality threshold should differ whether under an IRM or a cost of service regime. Indeed, no party has taken issue with THESL having met the materiality criterion.

Was the emergency caused by exogenous factors?

THESL stated that the exogeneity of costs refers to their character as having been externally imposed or required, as distinct from being discretionary and voluntarily undertaken. THESL maintains that the Level III costs it incurred met the exogeneity criterion because it was imperative for reasons of public and worker safety to correct any instances of faulty electrification as soon as possible using all reasonable measures.

In the view of VECC, SEC and Staff, the Applicant has not demonstrated that the costs were incurred as a result of events outside of THESL's control; rather, the costs incurred were caused primarily by THESL's failure to maintain or plan for the maintenance of end of life assets. However, in Staff's view, the unique nature of the emergency in which the contact voltage remediation costs were incurred may allow for a broader application of the exogeneity test.

In the Panel's view, whether as a Z factor or as relief for an extraordinary event, a request for relief must be accompanied by a demonstration that the management of the distributor could not have been able to plan and budget for the event.

The causes of the contact voltage problems are described or conceded by THESL as a) missing plastic caps, degraded or faulty insulation, and improper repacking of the conductors, b) more generally wear and failure of assets nearing the end of their life cycle, and c) bifurcated ownership and control of the secondary distribution system. THESL also conceded that it ran the secondary system on a "run to failure" basis. These causes demonstrate that the contact voltage emergency was not caused by a single event.

Exogenous events are normally thought of as externally imposed events such as major storms or unexpected tax changes - occurrences that are clearly beyond management

control. It is true that given the nature of the emergency, the expenditures in this case may not have been discretionary or voluntarily undertaken. No doubt, it was imperative for reasons of public and worker safety to correct any instances of faulty electrification as soon as possible using all reasonable measures. However, the non-discretionary and non-voluntary nature does not make the contact voltage emergency synonymous with exogeneity, as THESL maintains. An ice storm is exogenous. Hazardous situations arising from an insufficiently maintained handwell system, justified or not, cannot be characterized as exogenous.

However, it is the Panel's view that failing the exogeneity test should not be fatal to the application in this unique case unless it is also found that THESL was imprudent in the period prior to the emergency.

Certain parties argued that THESL did not follow good utility practice in the period leading up to the emergency in that if it did not know about the potential for contact voltage, it should have.

The Panel accepts THESL's argument that based on contact voltage occurrences in Toronto and elsewhere in Ontario prior to 2009 there was no reasonable indication or basis to conclude that contact voltage was an imminent threat and that occurrences elsewhere in North America indicated that it was an uncommon, isolated problem in a few systems and was not endemic. The Panel does not find that the Applicant has acted imprudently in the circumstances that prevailed on the contact voltage issue prior to 2009 and on the information the Applicant had in its possession. The contact voltage matter was not considered as a significant enough problem by electricity distributors to have been raised before the Board prior to this time.

Therefore the failure of meeting the exogeneity test is not fatal to the application as the Panel does not find that the Applicant has not generally followed good utility practice on the issue other than its "run to failure" practice which has resulted in certain additional costs that would have been avoided if they were not incurred in an emergency setting. The Panel deals with these costs below.

Are the expenditures incremental?

THESL's evidence was that the costs incurred in connection with the emergency were truly incremental to the requested and allowed operating expenditure amounts

underpinning 2009 rates. THESL stated that if its expenses were examined category by category, those for Electrical Contractors, Scanning Contractors, Inventory and Materials, and Other (including External Services, Rental Vehicles and Communication) were directly caused by the Level III emergency situation and would not have been incurred but for that event. With respect to regular labour and other miscellaneous internal costs charged to the Level III emergency project, THESL maintained that these were properly considered incremental to the approved revenue requirement because THESL is committed to achieving its planned and approved levels of operations and maintenance and capital work in 2009 and will therefore at least exhaust its approved revenue requirement in this category.

No party took issue with THESL's evidence that there were no amounts included in the 2009 test year by way of allowance for such an emergency event. However parties argued that there is little basis for THESL to claim that all of the costs were truly incremental.

In the view of VECC, SEC and Staff, the Applicant failed to demonstrate that the costs claimed are truly incremental to its 2009 revenue requirement. This resulted from THESL's failure to file evidence relating to 2009 spending, and more specifically its failure to bring this application within the context of a general rate filing. Parties referred to THESL's commitment to achieving its planned and approved levels of operations, maintenance and capital work in 2009 but noted that THESL's 2009 Bridge Year forecast contained in its 2010 Electricity Rate Application (EB-2009-0139) showed that the "Operations" and "Maintenance" expense categories (within total OM&A) are expected to be \$12 million below the 2009 Board-approved level. While it was also noted that the "Administrative and General" component was expected to be \$13 million higher than Board-approved, it was noted that these numbers would suggest that the present underspending of \$12 million in the "Operations" and "Maintenance" categories would be sufficient to cover most of the costs of the Level III emergency.

Staff however acknowledged that in its normal practice the Board does not implement rate adjustments in order to reconcile approved forecasts to actual revenue requirements. However, Z factor applications are filed in a year in which a utility is under IRM. THESL's case appears to be unique in that it has sought a Z factor type adjustment in a year in which it has also filed for a cost of service review, on the heels of a Board having approved rates for two years under cost of service. In Staff's view,

the status of 2009 actual spending is relevant to this particular case and should be the basis for testing the incrementality of the costs incurred.

The Panel notes THESL's repeated statements that it plans to complete its 2009 work plan with no alteration. This was THESL's own decision to make and presumed to have been made in light of an assessment of the priorities and the risks. THESL's statements however were not and could not be backed by evidence given the framing of its application. The Panel does not accept the proposition that it should deny the application on the basis that the forecast underspending in the "Operations" and "Maintenance" expense categories would cover the requested relief without giving any consideration to variations in the other controllable expense categories, such as the "Administrative and General" category. To do so would be too selective in this case. On the other hand, the Panel is concerned that if in fact there is underspending in the 2009 total controllable OM&A, it would confer a double benefit to the shareholder.

The Panel therefore finds that it would be reasonable in the circumstances for any relief provided in this Decision to be conditional on THESL's actual spending in controllable OM&A expenditures for the 2009 year (ending December 31, 2009). In the event that THESL's actual controllable OM&A expenditures are below the level reflected in THESL's 2009 approved base rates, the amount of the relief eligible for recovery found below shall be reduced by the amount of the underspending. To emphasize, this finding is not intended to reopen the testing of the 2009 revenue requirement nor the prudence of the actual 2009 OM&A spending.

Based on the information filed in the proceeding from THESL's 2010 rates application, the total OM&A level used to derive 2009 rates was \$350.0 million. Excluding amortizations expenses of \$154.4 million, the total controllable expenses used to derive 2009 rates was \$195.6 million. Any underspending in OM&A controllable expenses below \$195.6 million shall be deducted from the conditional relief found in this Decision. THESL's audited 2009 statements shall be the basis of determining the level of underspending, if any.

What cost amounts are eligible for recovery?

In THESL's view, the prudence test for the Level III emergency costs is whether the costs were reasonable and effective in producing the required results in the circumstances and with the information available to management at the time of the

event. THESL argued that the assessment of prudence should be undertaken with due regard to THESL's responsibility to respond immediately and effectively to a demonstrated and serious threat to public safety. Consideration of approaches that might be taken in non-emergency circumstances is irrelevant in THESL's view to a determination of prudence in this case. In addition, THESL noted that the reasonableness of the measures and costs undertaken should be assessed by considering whether alternative approaches might have instead been used with greater effectiveness or lower cost, given the information at that time and the resources available.

Staff argued for the disallowance of the \$2.15 million in overtime labour costs as this cost would not have arisen in a non-emergency situation. Also, Staff noted THESL's acknowledgment that the costs would have been lower if they had been incurred under non-emergency conditions, but as THESL was not able to quantify this amount, Staff argued for a further 15% disallowance.

Energy Probe argued that some of the costs incurred for addressing the contact voltage problems offset some OM&A costs reflected in existing rates. For example, costs for trouble crews used in the emergency during their usual shifts were already embedded in rates and should not be recovered as part of the Z factor costs. Energy Probe also noted that some of the remediation work undertaken during the emergency would have otherwise arisen as forced outages of secondary circuits. THESL would have responded to those events as normal trouble calls and the costs would have been reflected in its 2009 revenue requirement for OM&A. Energy Probe also argued that because the faulty components were repaired during the emergency, THESL has avoided the costs of repairing them under normal operating conditions. Therefore some part of the claimed remediation costs of \$11.9 million should be disallowed. Energy Probe suggested the \$1 million materiality threshold should serve as a "deductible."

Energy Probe further suggested that THESI, as the owner of the street lighting assets, should bear some of the costs of the emergency on the basis that a lack of maintenance on its street lighting assets was a major contributing cause of the contact voltage emergency. Energy Probe recommended that this amount should be set at 25% of the remaining \$10.94 million total cost, or a further reduction of \$2.74 million.

Energy Probe and SEC argued that once the emergency event was dealt with, ongoing scanning of the system was no longer required. Therefore, the claimed \$2.41 million for

this cost should not be approved for recovery as a Z factor. Energy Probe further noted that scanning for contact voltage during seasons in which it is unlikely to occur is not a prudent expenditure.

Some intervenors raised the issue of whether ratepayers are getting the best value from the sole-source contract with Power Survey Corporation for scanning services. In their view there is inadequate support to satisfy the value for money requirement, given the multi-year multi-million dollars involved.

The Panel is of the view that THESL would not have incurred overtime maintenance costs had the necessary secondary system maintenance been undertaken as part of its ongoing maintenance program. The lack of maintenance by THESI on its street lighting assets was a major contributing cause of the contact voltage emergency and as such it is a contributing factor to these overtime costs. Also, as Energy Probe noted, some of the remediation work undertaken during the emergency would have otherwise arisen as forced outages of secondary circuits as THESL would have responded to those events as normal trouble calls and the costs would have been reflected in its 2009 revenue requirement for OM&A. For these reasons, the Panel reduces the requested relief by a deemed amount of \$2.5 million.

The Panel further reduces the requested relief by \$2.41 million in ongoing scanning costs as suggested by Energy Probe and SEC for the reason that once the emergency event was dealt with, the costs for ongoing scanning of the system cannot be characterized as emergency related. Once the emergency was resolved and THESL made a decision to change its operating parameters of the secondary system to an inspect and maintain model, these costs were part of normal budgetary pressures that are subject to budgetary re-alignments. While the Panel accepts that sole-sourcing the scanning service for purposes of the emergency was not imprudent in the circumstances of the emergency, in light of the finding that the ongoing scanning costs are not recoverable as part of the relief requested, this Panel does not need to deal here with the multi-year sole sourcing aspects of the issue raised by some parties. This is an issue for a future proceeding.

The total reduction to the requested relief is \$4.91 million. The total conditional relief therefore found by the Panel is \$9.44 million.

Since this relief is subject to further reduction as explained elsewhere, the Panel will not approve at this time recovery of the \$9.44 million starting May 1, 2010, a date requested by the Applicant. Rather, the Board authorizes the Applicant to record in a sub-account of account 1572 (Extraordinary Events Costs) an amount of \$9.44 million for review at a later time once the 2009 audited financial results are known and upon application by THESL to clear the balance in the sub-account. In its application to recover the requested relief through rate riders, THESL had not incorporated interest. In any event, until the disposition matter is brought forward by THESL there will be no interest on the \$9.44 million amount.

How should the costs be allocated and recovered?

In a letter dated March 4, 2009 entitled “Wiring faults – servicing unmetered load connections,” sent by the Board to all electricity distributors, the Board stated that distributors are expected to recover from the customer the cost of repairs or isolation of customer owned equipment or connections through the use of a one-time billing charge or direct invoice.

THESL stated that the Level III emergency situation was distinctly and significantly different from business as usual. This was because, in contrast to the situation where a discrete piece of work is done on equipment for which the ownership is clear, the Level III emergency involved work on underground assets which in many cases were only nominally demarcated, making it difficult to distinguish whether the secondary equipment was a THESL, THESI or other third party asset. THESL reiterated that the situation did not permit the time and effort to disentangle, analyze and record whose was the faulty asset, and the circumstances did not support the usual recognition of and billing for work done on customer-owned equipment. THESL also reiterated that its recovery proposal would mean that costs would be recovered in a manner that would result in an outcome substantially similar to that which likely would have prevailed had it been possible to discretely record and cost each individual piece of remediation work.

A major focus of argument by intervenors and Staff was on the allocation of scanning costs to the Streetlighting and USL classes. It was generally suggested that all or most of the scanning costs be allocated to the Streetlighting and USL rate classes as it was perceived that it was the assets owned by or serving these classes that caused the contact voltage problem in the first place.

THESL responded that the disagreement stems from either a misunderstanding of the evidence or parties are not willing to accept the evidence. It explained that contact voltage does not follow familiar cause and effect relationships that characterize the rest of the electrical plant. THESL noted that it is incorrect to suggest that if x% of the contact voltage instances were exhibited by equipment in a particular category, that that equipment caused x% of the contact voltage problem or that x% of the costs should be allocated to customers taking service from that equipment. A defective connection in a THESL vault could result in contact voltage appearing on a streetlight pole owned by THESI some distance away. The streetlight pole would have exhibited contact voltage but it does not follow and often it was not the case that the streetlight pole caused the contact voltage. When the problem at the THESL vault is corrected, THESL stated that the contact voltage exhibited by the streetlight pole would vanish without the pole being touched. THESL stated that scanning is not directed to any specific class or class of assets, or even exclusively to THESL assets. The secondary system serves all customer classes, not just the Streetlighting and USL classes. THESL therefore applied an allocation of secondary related cost which follows the Board's cost allocation principles.

The Panel accepts THESL's explanation and clarification on the cause and manifestation of contact voltages. The Panel finds THESL's proposed cost allocation reasonable.

Another point of contention raised by some intervenors was that THESL did not create records enabling the direct tracing of fault repair costs to asset owners so that they could then be charged.

THESL responded that in its written evidence and oral testimony it has made its reasons clear. The circumstances of the emergency did not permit the creation of such records as doing so would have slowed the remediation of contact voltages "very substantially" and would itself have been "very costly". Further, it would have related to only a fraction of the work done. The Panel accepts THESL's reasons for not attempting to create such records.

THESL proposed that the recovery of amounts allocated to rate classes other than Streetlighting and USL be recovered over 12 months commencing May 1, 2010 by way of rate riders calculated as fixed monthly amounts per customer as applicable. For the USL and Streetlighting classes, THESL proposed that in view of the significant bill

impacts involved, the costs should be recovered over three years. No party opposed THESL's proposals.

Based on the Panel's findings, the maximum recovery amount is reduced for all rate classes, but mainly for the Residential and small General Service classes as these classes were burdened with the bulk of the scanning costs, which have been reduced substantially by the Panel. While the amounts to be recovered from the USL and Streetlighting classes will not be reduced proportionally, they will be reduced somewhat. The ultimate recovery amount may be reduced further for all rate classes at the time the Applicant's audited financial statements are available. Therefore, the Panel will not make a finding as to the appropriate recovery period or method of recovery. These matters will be dealt with when the Applicant brings forward an application for disposing of any balances in the noted 1572 sub-account.

Cost Awards

The Board may grant cost awards to eligible stakeholders pursuant to its power under section 30 of the *Ontario Energy Board Act, 1998*. When determining the amount of the cost awards, the Board will apply the principles set out in section 5 of the Board's Practice Direction on Cost Awards. The maximum hourly rates set out in the Board's Cost Awards Tariff will also be applied.

The Board will issue a decision on costs awards after the completion of the following steps:

1. Intervenors shall file with the Board and forward to THESL their respective cost claims within 14 days from the date of this Decision.
2. THESL shall file with the Board and forward to intervenors any objections to the claimed costs within 28 calendar days from the date of this Decision.
3. Intervenors shall file with the Board and forward to THESL any responses to any objections for cost claims within 44 calendar days from the date of this Decision.

THESL shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

DATED at Toronto, December 11, 2009

ONTARIO ENERGY BOARD

Original Signed By

Paul Vlahos
Presiding Member