Ontario Energy Board
P.O. Box 2319
2300 Yonge Street
Suite 2700
Toronto ON M4P 1E4
Telephone: 416- 481-1967
Facsimile: 416- 440-7656
Toll free: 1-888-632-6273

Commission de l'énergie de l'Ontario
C.P. 2319
2300, rue Yonge
Suite 2700
Toronto ON M4P 1E4
Téléphone; 416- 481-1967
Télécopieur: 416- 440-7656
Numéro sans frais: 1-888-632-6273

Ontario

BY E-MAIL

January 19, 2009

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto ON M4P 1E4

Dear Ms. Walli:

Re: Hydro One Networks Inc. – 2008 Rates
Board Staff Submission, Hydro One Networks Inc. draft Rate Order
Board File No. EB-2007-0681

Please find attached Board staff's Submission on the Draft Rate Order filed by Hydro One Networks Inc. Please forward the attached documents to Hydro One Networks Inc. and all other parties in this proceeding.

Yours truly,

Original Signed By

Adrian Pye
Manager, Natural Gas Rates, Applications

Encl.

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2008 ELECTRICITY DISTRIBUTION RATES

HYDRO ONE NETWORKS INC.

COMMENTS ON DRAFT RATE ORDER

EB-2007-0681

January 19, 2009

OVERVIEW

The Board issued its Decision on December 18, 2008. Hydro One Networks Inc. ("Hydro One") filed its Draft Rate Order on January 12, 2009.

HYDRO ONE'S DRAFT RATE ORDER

It is Board staff's submission that the Draft Rate Order should be accepted as filed. Hydro One's Draft Rate Order complies with the Board's Decision, however, Board staff notes that there are several issues which Hydro One must address and about which submissions have been prepared.

Board staff has specific submissions on the following areas of the Draft Rate Order:
- Rate Base and Capital Expenditures
- Cost of Capital

RATE BASE AND CAPITAL EXPENDITURES

Board staff have reviewed Hydro One's adjustments to net fixed assets to rate base and associated adjustments to depreciation, which are shown in Exhibit 1.3. Board staff takes no issue with these adjustments for net fixed assets and capital expenditures.

However, Hydro One has not adjusted the rate base to reflect changes in working capital allowance ("WCA"). In Exhibit 1.0, a reduction in Operating, Maintenance & Administrative Expenses of $11.4 million is noted. This would flow through per the methodology that sets Hydro One's WCA at 11.2% of the sum of Cost of Power and controllable expenses. Staff estimates, based on simplified calculations, that this means that the revenue requirement is overstated by between $100 000 and $200 000, per year, until the next rebasing period. Board staff does not believe that this amount would materially impact Hydro One's proposed rates.

Board staff submits that updating the WCA to reflect the changes to OM&A is standard practice, and would be consistent with the Settlement Agreement. The WCA was partially settled in the Settlement Agreement, but the settlement pertains to the methodology for calculating the WCA as 11.2% of the sum of controllable expenses plus cost of power, and not the proposed quantum of $273.2 million, as shown from the Settlement Agreement (Exhibit L / Tab 1 / Schedule 1 / page 17) below:

> 4.7 Are the methodologies used to allocate Shared Services and Other Capital expenditures to the distribution business and determine the Working Capital component of the Rate Base consistent with the methodologies approved by the Board in previous Hydro One rate applications?
>
> **Partially Settled**. The parties agree that the methodology used by the Applicant to determine the Working Capital of $273.2 million is consistent with the methodology approved by the Board at page 29 of their EB-2005-0378 Decision. This amount

represents 11.2% of total OM&A and cost of power. The settlement of this issue was also accepted by the Board in proceeding EB-2006-0501.

As noted above, Board staff estimate that the update would not materially impact the revenue requirement or the resulting distribution rates. However, Board staff submits that Hydro One should, in future, comply with Board practice and should flow through changes in OM&A and cost of power where they would impact on Working Capital, Rate Base, Net Income, PILs and ultimately revenue requirement.

With respect to Smart Meters, on page 2 of the DRO material, Hydro One states that the $0.93/month per metered customer smart meter funding adder will continue, and has been incorporated into existing rates. However, Hydro One has not provided the derivation of the proposed rates, and staff are unable to confirm the continuation of the $0.93 smart meter funding adder.

COST OF CAPITAL

Cost of capital was a settled issue, whereby Hydro One would use the Board-issued Return on Equity ("ROE") and long- and short-term debt rates. Hydro One has provided the calculations in Exhibit 1.5. Subject to rounding errors and one comment following, Board staff concurs with Hydro One's calculation of the cost of capital.

Hydro One has used a slightly different approach for calculating the interest expense on the deemed capital structure than is used for other distributors. However, it is staff's submission that Hydro One's approach is a plausible interpretation, and the impact of updating this calculation would be deminimus.

In its Draft Rate Order material, as shown in Table 1.5, Hydro One has applied the actual third-party debt rate (5.71%) to actual third-party debt of $2,325.8 million (54.8% of capital), and applies the deemed long-term debt rate of 6.10% to $52.7 million (1.2%) of "deemed" long-term debt. For other distributors, the average cost of debt, calculated as a weighted average of actual and deemed debt costs based on actual debt, would apply. Similar application by Hydro One would use the actual third-party debt rate of 5.71% to the total deemed long-term debt of 56.0% of rate base.

~ ALL OF WHICH IS RESPECTFULLY SUBMITTED ~