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

AND IN THE MATTER OF a review of an application filed by Hydro One Networks Inc. under section 78 of the *Ontario Energy Board Act, 1998*, seeking changes to the uniform provincial transmission rates.

BUILDING OWNERS AND MANAGERS ASSOCIATION OF THE GREATER TORONTO AREA ("BOMA")

AND

LONDON PROPERTY MANAGEMENT ASSOCIATION ("LPMA")

ARGUMENT

March 20, 2009

ARGUMENT OF
BUILDING OWNERS AND MANAGERS ASSOCIATION OF THE GREATER TORONTO AREA
("BOMA")
AND
THE LONDON PROPERTY MANAGEMENT ASSOCIATION
("LPMA")

INTRODUCTION

This is the Argument of the Building Owners and Managers Association of the Greater Toronto Area ("BOMA") and the London Property Management Association ("LPMA") related to the setting of 2009 and 2010 uniform provincial transmission rates based on a revised revenue requirement for Hydro One Networks Inc ("Hydro One"). Hydro One proposed to change rates effective July 1, 2009 and January 1, 2010.

This Argument has been structured to reflect the major components of the Hydro One evidence. Where readily available, BOMA & LPMA have attempted to provide the impact of its submissions on the revenue requirement of Hydro One. However, a comprehensive impact analysis has not been undertaken. If the Board accepts any or all of the BOMA & LPMA submissions, it is assumed that the direct and indirect impacts will be determined by Hydro One and reviewed by intervenors and Board Staff. An example of a comprehensive impact analysis would include the direct impact on rate base of a $25,000 reduction in capital expenditures. Depreciation expense would also be directly impacted by the capital expenditure change. The indirect impacts would include the change in total cost of capital and taxes (due to CCA and interest costs). Similarly there would be a direct impact of a change in OM&A expenses on the revenue requirement, while the indirect impact would be the change in the working capital allowance component of rate base.

Hydro One is forecasting a revenue requirement of $1,232.7 million in 2009 and $1,341.0 in 2010 (Exhibit E1, Tab 1, Schedule 1, Table 1). These figures represent increases in the total revenue requirement of $62 million in 2009 (Table 2) from the OEB approved level of $1,170 million for 2008 and a further incremental $108 million in 2010 (Table 4). The increase in 2009 is 5.4% over the 2008 approved level. The cumulative increase in 2010 is 14.6% over the 2008 approved revenue requirement.

The rates revenue requirement, which is also shown in Exhibit E1, Tab 1, Schedule 1 increases from $1,137 million as approved by the OEB for 2008 to $1,199 million in 2009 and to $1,309 million in 2010. These increases are $62 million or 5.5% in 2009 and a further $110 million or 9.2% in 2010. The cumulative increase in 2010 over the 2008 Board approved level is 15.1%. The rates revenue requirements reflects the total revenue requirement with deductions for external revenues, the export revenue credit and other cost charges and the addition of costs associated with low voltage switch gear. These adjustments are shown in Tables 2 and 4 of Exhibit E1, Tab 1, Schedule 1 for 2009 and 2010, respectively.

The impact on the uniform provincial transmission rates has been calculated by Hydro One to be an increase of 6.4% in 2009 and 12.1% in 2010 (Exhibit A, Tab 3, Schedule 1, page 3).

The submissions that follow reflect the areas where BOMA & LPMA believe that adjustments should be made to Hydro One's forecasts and/or proposals. Submissions are also provided on the Association of Major Power Consumers in Ontario ("AMPCO") proposal related to transmission rate design.

CHANGE IN ECONOMIC CIRCUMSTANCES

Hydro One's evidence was prepared nearly 12 months ago. As shown in Exhibit K3.2, the Sunnybrook Planning Summit meetings took place on April 17, 2008 and May 6, 2008. A lot has happened since that timeframe and most of it is negative.

The auto industry has been rocked and the financial sector shocked. Unemployment has risen to levels not seen for many years and it is still on the rise. Businesses are relocating outside of Canada or simply closing. Talk of inflation has turned to concerns of deflation. Consumer confidence and spending have fallen and continue to decline.

An increase in transmission rates of the magnitude proposed by Hydro One in this application would be significant in good economic times. In bad economic times they have the potential to be devastating. Consumers of electricity, whether they be residential customers, manufacturing companies, schools, hospitals, large commercial properties or a neighbourhood convenience store, can ill afford any increase in rates and costs that are over and above that which is absolutely required. Prudence is required now, more than ever.

BOMA & LPMA urge the Board to keep the state of the economy front and center when considering their Decision and the impact it will have on electricity consumers.

BOMA & LPMA note that Hydro One is requesting a return on equity based on the Board's formulaic approach in Appendix B of the Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors, dated December 20, 2006. This formulaic approach sets the maximum return on equity.

In light of the current state of the economy, BOMA & LPMA urge Hydro One to re-evaluate their request for the maximum return on equity. As shown in the response to a BOMA & LPMA interrogatory (Exhibit I, Tab 2, Schedule 1) a ten basis point reduction in the return on equity would reduce the revenue requirement in 2009 by $4.2 million and by $4.5 million in 2010. Even a small reduction of 25 basis points on the requested return on equity would reduce the revenue requirement in 2009 by more than $10 million and by more than $11 million in 2010. These reductions would go a long way to mitigating the rate impact on customers in the coming months and years when they can least afford an increase.

RATE BASE

a) Capital Expenditures

Hydro One is forecasting a significant increase in the level of capital expenditure sin 2009 and 2010, as shown in Table 1 of Exhibit D1, Tab 3, Schedule 1, Updated. In fact, the expenditures in 2010 are more than triple the expenditures that took place in 2005.

However, as shown in Tables 2 and 3 of the same Exhibit, Hydro One has had problems in the last two years when it comes to investing in what they say they will. The following table is a summary of the Board Approved and actual capital expenditures for 2007 and 2008.

Year	Actual	Board Approved	Variance
2007	$559.5	$711.6	$(152.1)
2008	$704.2	$774.4	$(70.2)
Total	$1,263.7	$1,486.0	$(222.3)

As shown in the above Table, Hydro One under spent compared to the Board approved figure in both 2007 and 2008. In 2007, Hydro One spent 21% less that the Board Approved budget. In 2008, spending was 9% below budget. In aggregate, Hydro One spent 15% less than the Board approved budgets approved in EB-2006-0501, a variance of more than $220 million.

With a significant increase in the level of capital expenditures forecast for 2009 and 2010 as compared to the Board approved levels in 2007 and 2008, coupled with their performance in 2007 and 2008 as shown above, BOMA & LPMA submit that there is a real question as to whether Hydro One can achieve their forecast. While Hydro One may intend to follow through on its budget plans, their actions have resulted in significant variances.

As noted above, the capital expenditures in 2007 and 2008 were below the EB-2006-0501 Board approved levels by 15%. BOMA & LPMA submit that this should cause great concern to the Board. Hydro One recovered a cost of capital on more than $220 million where there was no cost of capital. Hydro One recovered depreciation expense on more than $220 million in assets when there were no assets to depreciation. Rates recovered significant costs that did not materialize.

As noted earlier, BOMA & LPMA believe that prudence is required. Any increase in rates must be backed by a track record that justifies the need for the increase. When it comes to capital spending, Hydro One lacks this track record. Indeed, their record is one of under spending. BOMA & LPMA submit that Hydro One has not provided any evidence to suggest that they have improved their budgeting methodology to ensure it has become more accurate.

Mr. Van Dusen indicated that were some issues with the level of capital expenditures planned for 2009 and 2010 (Tr. Vol. 3, pg. 89). In particular, there were issues in terms of resourcing the level of work that was being budgeted for, problems with material acquisition, and outage management. No doubt these were contributing factors in 2007 and 2008 to the under spending. Hydro One does not, however, indicate how it has changed or modified its budget process to more precisely reflect the impact of these issues. The budget process appears to be driven by asset need, modified for work execution issues at the Sunnybrook Summit 1 (Exhibit K3.2). No doubt the work execution issues were also addressed when the 2007 and 2008 budgets were being put together. Exhibit K3.2 provides no evidence of a change in the methodology that would generate a forecast that would accurately reflect the issues that impact on the work execution.

BOMA & LPMA submit that in the light of all of the above, a reduction in the capital expenditures forecast by Hydro One in both 2009 and 2010 of 10% is reasonable. This would reduce capital expenditures for 2009 to approximately $850 million and for 2010 to about $967 million. BOMA & LPMA believe these levels would be more manageable for Hydro One and reduce the risk to ratepayers that they are paying for assets that do not materialize in the test years, as was the case in 2007 and 2008. As indicated in the response in Exhibit I, Tab 2, Schedule 18, the resulting reduction in the revenue requirement of this 10% reduction in capital expenditures and assuming an equivalent reduction in in-service capital is an estimated $5 million in 2009 and $15 million in 2010.

b) Working Capital

BOMA & LPMA submit that any changes made by the Board in its Decision that have an impact on the figures used to calculate the working capital allowance shown in Exhibit

D1, Tab 1, Schedule 3 should be reflected in an updated calculation of the working capital allowance.

OM&A EXPENSES

a) Level of Forecast Expenses

Hydro One has forecast a substantial increase in the level of its OM&A expense in 2009 and 2008. Table 1 of Exhibit C1, Tab 2, Schedule 1 showed an increase in 2009 of 8.1% compared to the forecasted bridge year figure of $402.7 million. The increase in 2010 was a further 3.3% over the 2009 level. The OM&A costs include sustaining, development, operations, shared services and other OM&A and property taxes & rights payments.

As part of the February 13, 2009 update of their evidence to reflect actual bridge year figures for 2008, Hydro One provided an update to Table 1 of Exhibit C1, Tab 2, Schedule 1. As shown in this response, the actual 2008 OM&A costs fell by 9.5% to $373.8 million in 2008 from the level recorded in 2007 of $412.7 million. The actual level of OM&A costs was 7.2% or $28.9 million lower than that forecast for 2008 in the original evidence.

Hydro One has not changed its forecast for either 2009 or 2010 to reflect the significantly lower actual OM&A cost in 2008 from that originally forecast, and upon which the 2009 and 2010 forecasts should be based. The increase for 2009 is now an astounding $61.4 million or 16.4% over the actual 2008 level. BOMA & LPMA submit that this proposed increase is neither reasonable nor justified by the evidence provided by Hydro One.

BOMA & LPMA have analyzed the increase in OM&A expense based on the information provided in the filing and submits that there should be a substantial reduction in the OM&A costs included in the revenue requirement in both 2009 and 2010. It is submitted that the Board should reduce the OM&A forecast based on the average of the three approaches that follow.

BOMA & LPMA believe that Hydro One should maintain the level of OM&A work to be performed consistent with past levels over the 2005 through 2008 period. This would mean that the changes in the overall OM&A costs would be driven by the price of doing the work and the change in the mix of the work being performed, but not the absolute amount of work being done.

<u>i) Growth Rate from Original Forecast</u>

Hydro One's original forecast had an increase in OM&A forecast for 2009 of 8.1% from the level forecast for 2008. In 2010 there was a further increase forecast of 3.3%.

The actual level of OM&A expenditures for 2008 was substantially lower than that forecast by Hydro One less than year ago. The actual level of OM&A costs was 7.2% or $28.9 million below the forecast level. Despite this significant reduction, Hydro One did not make any adjustment to their forecast levels for 2009 or 2010.

BOMA & LPMA submit that the forecasted OM&A expenses should be reduced to reflect the actual decrease (from forecast and from actual 2007 expenditures) in the 2008 costs. Applying the original forecast of an 8.1% increase in 2009 and a further 3.3% increase in 2010 to the actual 2008 base expenditures would result in a 2009 forecast of $404.1 million and a 2010 forecast of $417.4 million. These levels represent a decrease of $31.1 million and $32.2 million for 2009 and 2010, respectively.

<u>ii) Consumer Price Index</u>

Hydro One states that the Consumer Price Index (CPI) provides a broad measure of the cost of living. In particular, Hydro One states that "*the CPI-Ontario exhibits the inflationary environment in which Hydro One Transmission operates*" (Exhibit A, Tab 14, Schedule 2, pages 2 - 3). The company further indicates that the CPI is used as planning tool to forecast expenditure level changes for items such as fleet and sundry costs.

An analysis of the OM&A expenditures found in Table 1 of Exhibit C1, Tab 2, Schedule 1, Updated shows that the actual expenditures increased 9.36% between 2008 ($373.8 million) and 2005 ($341.8 million). This represents an annual average compound growth rate of 3.03%. Over this same period, the Ontario CPI increased by an average compound growth rate of 1.96% from a level of 106.9 in 2005 to 113.3 in 2008. These figures are publicly available from Statistics Canada and can be found on their website.

BOMA & LPMA submit that one way to analyze the forecast figures for 2009 and 2010 is to compare the recent historical increases in expenditures relative to the change in the Ontario CPI and apply this differential to the forecast CPI for 2009 and 2010.

As noted above, the increase in OM&A expenses have increased by an annual average compound growth rate of 3.03%, while the Ontario CPI has increased by an average of 1.96% over this same period. In other words, the OM&A costs have grown by 1.07% per year faster than inflation over this period.

BOMA & LPMA submit that if this differential is tripled to 3.21% and added onto the Ontario CPI inflation forecast; this should provide a reasonable forecast for the increase in OM&A costs for 2009 and 2010. The tripling of the differential reflects that for any individual year there can be significant differences between the escalation of OM&A costs and the broad measure of the cost of living in Ontario. Over an extended period, however, there should be a relatively constant differential.

Hydro One's evidence contains a forecast for the Ontario CPI in Table 2 of Exhibit A, Tab 14, Schedule 2. Hydro One did not update this forecast to reflect the changes in the economic circumstances that have taken place since that forecast was prepared by Global Insight in December, 2007. The current outlook is for significantly lower inflation as the demand for goods and services weakens as a result of rising unemployment levels and falling consumer confidence. Discussions have even turned to the problems associated with deflation.

Nevertheless, taking the 2.3% increase in the Ontario CPI for 2009 and the 2.0% increase for 2010 as provided by Hydro One in their evidence and increasing these values for three times this recent historical differential in cost increases would result in cost increases of 5.51% in 2009 and 5.21% in 2010. Application of these increases to the actual 2008 expense level of $373.8 million result in substantially lower forecasts: $394.4 million in 2009 and $414.9 million in 2010. These levels represent a decrease of $40.8 million and $34.8 million for 2009 and 2010, respectively.

iii) Transmission O&M Cost Escalation

Similar to the approach related to the Ontario CPI, an approach that takes into account the differential between actual expense growth relative to the increase in the costs for operations & maintenance for transmission related costs is also appropriate.

Unlike the Ontario CPI which is a broad measure of the cost of living, the transmission cost escalation for operations & maintenance costs provides "*a broad average measure of the industry-wide yearly price changes by tracking a representative basket of equipment and labour for these areas of business*" (Exhibit A, Tab 14, Schedule 2, page 1). The evidence then goes on to list a basket of goods that is comprised of numerous types of equipment and labour including operation, supervision and engineering, lines, meters, load dispatching, maintenance and many more.

As noted above, the Hydro One OM&A costs increased by an average annual compound rate of 3.03% from 2005 to 2008. Over this same period, the average annual compound growth rate in the Transmission Cost Escalation for Operations & Maintenance was 3.40%. This figure can be determined from the increases shown in Table 1 of Exhibit A, Tab 14, Schedule 2. A comparison of these two figures indicates that the escalation in Hydro One costs has actually been lower than the industry-wide escalation in costs.

Assuming that the Hydro One costs increase at the same rate as the forecast for the Transmission Cost Escalation for Operations & Maintenance shown in Table 1 of Exhibit A, Tab 14, Schedule 2, of 1.4% and 0.7%, the OM&A expenses would total $379.0

million and $381.7 million for 2009 and 2010. These levels represent a decrease of $56.2 million and $68.0 million for 2009 and 2010, respectively.

iv) Summary

BOMA & LPMA have provided an analysis of the OM&A costs based on three different approaches. Each of these approaches has strengths and weaknesses. Some provide a comparison to an industry-specific measure of cost pressures, while some are done in relation to a broader measure of inflation. All are based on a historic relation between actual spending and forecast spending. The following table summarizes the forecasts derived from the three approaches above.

Approach	2009	2010
Growth Rate from Original Forecast	404.1	417.4
Consumer Price Index	394.4	414.9
Transmission Cost Escalator	379.0	381.7
Average	391.1	401.8

BOMA & LPMA submit that the Board should reduce the OM&A forecasts for 2009 and 2010 the average figures provided in the above table. These averages provide a reasonable estimate for the OM&A expenses for the two test years based on the historical costs and forecasts for inflation provided by Hydro One in their evidence. These figures represent a decrease in the OM&A component of the revenue requirement of $44.1 million in 2009 and $47.9 million in 2010. At the same time, the 2009 figure represents an increase of 4.6% relative to the level of expenditures in 2009. The increase in 2010 is 2.7%. BOMA & LPMA submit that these increases are reasonable given the current economic conditions.

It should also be pointed out that if the Board were to adopt the maximum figures shown in the above table, then OM&A costs would be $404.1 million in 2009 and $417.4 million in 2010. These figures would still represent a decrease of $31.1 million in 2009 and $32.6 million in 2010 from that proposed by Hydro One. The increase in 2009 from the actual 2008 level would be 8.1%, followed by a further increase of 3.3% in 2010.

b) Specific Reductions

Hydro One indicated that if the Board were to decide that the spending plans as filed were unacceptable it would find it helpful if the Board could specify where adjustments could be made. (Tr. Vol. 3, page 11).

BOMA & LPMA do not believe that the Board should provide specific areas and amounts where reductions should or could be implemented relative to the forecast plans. As the test years progress, there will be differences between what needs to done from that forecast by Hydro One. This would be the case even if the Board determines that no adjustment should be made to the overall OM&A expenses forecast by Hydro One. Any adjustments specified by the Board may have the unintended consequence of impacting on what needs to be done rather than simply affecting what was forecast to be done.

BOMA & LPMA do, however, provide some suggestions to the Board where some of the $30 to $45 million in reductions proposed in each of 2009 and 2010 could be achieved.

The first of these is a reduction in compensation levels. As shown in the response to Undertaking J3.5, Hydro One has estimated that if its compensation was equivalent to the market median, rather than being substantially above it, the impact would be a reduction of about $13 million in each of 2009 and 2010. As indicated in Exhibit A, Tab 16, Schedule 2, page 2, Hydro One's compensation cost is approximately 17% above the market median.

Hydro One indicates that it cannot adjust the various collective agreements that are in place through to the end of 2010 with approximately 90% of its workforce. However, this does not mean that ratepayers are required to pay these costs if the Board finds them to be excessive. Hydro One notes it could reduce the costs by reducing the work programs.

The second area where a reduction in costs could be achieved is an increase in productivity. Part of the Mercer/Oliver Wyman report dealt with productivity. Hydro

One concluded at Exhibit A, Tab 16, Schedule 2, page 3 that Hydro One's productivity is better than or equal to the median performance.

BOMA & LPMA agree with the Energy Probe submission that the conclusion that Hydro One is as productive as the median is incorrect. BOMA & LPMA support the submissions of Energy Probe in this area (Issue 3.3) and will not repeat them here.

The net result is that Hydro One has significant room for improvement in productivity to achieve the median or improve upon it. Productivity improvements could go a long way in reducing the increase in OM&A costs going forward.

Thirdly, BOMA & LPMA support the analysis and submissions of Energy Probe with respect to sustaining OM&A (Issue 3.1). The evidence does not support the increase in expenditures above historical levels related to the number of transformers and circuit breakers moving into the more maintenance intensive age classes.

Finally, the fourth area where reductions are quite feasible is the property tax related expenses. Hydro One had forecast an increase of 3.65% for 2009 and 3.10% for 2010 in the cost of property taxes, indemnity payments and rights payments in their original evidence for 2009 (Exhibit C1, Tab 2, Schedule 12, Table 1). Property taxes make up the vast majority of these costs. In the response to a BOMA & LPMA interrogatory, Hydro One indicated that the forecast for 2009 and 2010 was driven by an increase of 2% in each year related to property value reassessment, an annual 2% municipal tax increase and no change to proxy taxes (Exhibit I, Tab 2, Schedule 15).

However, as shown in the updated evidence, the actual 2008 property and other taxes were only $64.8 million, or $3.6 million lower than forecast. Applying these same cost drivers to the lower starting base - an increase of 3.65% in 2009 and 3.10% in 2010 - result in reductions of $3.7 million in 2009 and $3.9 million in 2010 from that forecast by Hydro One.

DEPRECIATION & AMORTIZATION

BOMA & LPMA note that depreciation & amortization costs make up a significant component of the overall revenue requirement. As shown in Table 1 in Exhibit E1, Tab 1, Schedule 1, depreciation & amortization costs represent 20.9% of the 2009 revenue requirement and 21.0% of the 2010 revenue requirement.

BOMA & LPMA accept the calculation of the depreciation expense as provided, including the Technical Update filed as Exhibit C1, Tab 6, Schedule 2, based on the capital expenditure forecast as proposed by Hydro One.

Elsewhere in this Argument, BOMA & LPMA submit that there should be significant reductions in the capital expenditures forecast for both 2009 and 2010. If the Board accepts any or all of those adjustments, it is the submission of BOMA & LPMA that the depreciation expense should be revised to reflect the Board approved capital expenditures.

TAXES

BOMA & LPMA have reviewed the calculation of income and capital taxes and accept the methodology as correct with the two exceptions noted below.

a) Apprenticeship & SR&ED Tax Credits

It is not clear from Attachment 1 to Exhibit C2, Tab 6, Schedule 1, whether or not Hydro One has included the reduction associated with the Apprenticeship Tax Credit or the Scientific Research and Experimental Development Tax Credit ("SR&ED") that is available to reduce taxes payable. Hydro One has reflected research & development input tax credits and Ontario education credits in its calculation of utility income taxes at lines 12, 13 and 20. It is not know whether these line items include either of the apprenticeship tax credit associated with the hiring and training of new linesmen or the SR&ED credit. The figures used in 2009 and 2010 are $0.2 million for each of the credits. However, as can be seen from a review of the 2007 tax filings in Exhibit C2, Tab 6, Schedule 2 (at page 50 of 86), the apprenticeship tax credit claimed in 2007 was

$620,156 and the SR&ED credit claimed was $746,178, for a total of more than $1.36 million.

BOMA & LPMA submit that both of these tax credits should be reflected in the regulatory income tax. This is especially true for the Apprenticeship Tax Credit since the wages and benefits associated with the roles that create this credit are included in the revenue requirement to be recovered through rates.

If Hydro One has not included one or both of these tax credits in the calculation of the regulatory taxable income, then BOMA & LPMA submits that the Board should direct them to do so. On the other hand, if these credits are reflected in the current calculation, then BOMA & LPMA submit that the Board should direct Hydro One to explain why the credits are substantially smaller in 2009 and 2010 than those claimed in 2007.

b) CCA – Computers

As acknowledged by the Hydro One witnesses, computers and systems software added to Class 50 is now eligible for a 100% CCA rate with no half year rule adjustments for assets acquitted in 2009 and 2010 (Tr. Vol. 3, pg. 76). This change was introduced as part of the January, 2009 federal budget. These assets are currently subject to the half year rule in the year of acquisition and to a 55% CCA rate.

As shown in Attachment 2 to Exhibit C2, Tab 6, Schedule 1, Hydro One had additions in Class 50 of $0.4 million in each of 2009 and 2010. Based on the current CCA calculations, these additions result in CCA deductions of $0.11 million in 2009 and $0.27 million in 2010. Application of the new rules for these additions will increase the CCA deduction to the full value of the additions, or $0.4 million in each of 2009 and 2010. The resulting reduction in taxable income is therefore $0.29 million in 2009 and $0.13 million in 2010.

BOMA & LPMA understand that there is a deferral account in which impacts of the changes in tax rates, including CCA rates can be recorded for future disposal. However, since this change is known, it is submitted that it should be implemented now.

REVENUES

BOMA & LPMA submit that export revenues and external revenues should be revised to reflect more realist forecasts than those provided by Hydro One.

a) Export Revenues

i) Forecast of Export Revenues

Export revenue has increased substantially in recent years. As shown in the response to a BOMA & LPMA undertaking (Exhibit J3.2) export revenues have risen from $13.25 million in 2006 to $14.1 million in 2007 and to $24.6 million in 2008. As shown in the Exhibit E1, Tab 1, Schedule 1, Table 2, the Board Approved level for the Export Revenue Credit that was used to reduce the total revenue requirement in 2008 was only $12 million. Hydro One is forecasting the same level of this credit in 2009 and 2010 as the Board approved for 2008.

The forecast of $12 million may have been reasonable for the 2008 rates application. BOMA & LPMA submit that it not a reasonable forecast given the actual experience in 2008. One reason for the significant increase in 2008 as compared to 2007 is the increase in the revenue generated by wheel through transactions. In 2007 these transactions represented 1% of the revenue. This increased to 23.7% of the year to date October, 2008 revenue (Exhibit I, Tab 6, Schedule 66).

BOMA & LPMA submit that a reasonable forecast for 2009 and 2010 for export revenues is the 2008 actual level of approximately $24 million, or an increase of $12 million. Hydro One has forecast a level that was consistent with the Board approved figure for 2008. However, with a forecast error of more than 100% BOMA & LPMA submit that the Board approved level for 2008 is no longer appropriate. The forecast should reflect the most recent information available and that information is the 2008 actual revenues recorded by Hydro One.

ii) Need for Variance Account

In addition to the increase in the export revenue forecast as proposed by BOMA & LPMA to $24 million, it is submitted that a variance account should be established around this forecast amount. The reasons for this are two-fold. First, the increase in export revenues in 2008 may be temporary, or it may be part of a trend. There is no evidence to suggest whether one of these possibilities is more of less likely than the other. A variance account protects both Hydro One and ratepayers from this forecast error.

The second reason for a variance account is that the ETS tariff may be changed. Hydro One has stated that it expects that the Board will initiate a process to review and approve the IESO recommendations from the ETS tariff study which are due no later than June 1, 2009. Any revenue impact as a result of the change in the tariff should also be recorded in the variance account, again to provide protection to both Hydro One and ratepayers.

b) External Revenues

BOMA & LPMA believe that net revenue generated by external revenues is too low. BOMA & LPMA have divided external revenues into two components. The first deals with the net revenues generated by station maintenance and engineering & construction. The second deals with the revenues generated by secondary land use. BOMA & LPMA accept as reasonable the forecasts for Other External Work.

Exhibit E1, Tab 1, Schedule 2, Updated, Table 1 shows the actual external revenues for 2005 through 2008 and the forecast for 2009 and 2010. Exhibit C1, Tab 2, Schedule 11, Updated, Table 1 shows the actual costs associated with external work for 2005 through 2008, with forecasts for 2009 and 2010. The information from both of these tables is utilized below.

i) Station Maintenance and Engineering & Construction

The following table provides a summary of the gross revenue, costs and net revenue associated with external revenues associated with station maintenance and engineering & construction work.

$M	2005 Actual	2006 Actual	2007 Actual	2008 Actual	2009 Forecast	2010 Forecast
Gross Revenue	19.5	19.7	18.2	21.9	4.9	4.4
Cost of Sales	15.7	16.6	14.5	20.5	4.1	3.7
Net Revenue	3.8	3.1	3.7	1.4	0.8	0.7

As shown in the above table, Hydro One is forecasting more than 40% reduction in net revenue in 2009 and a 50% reduction in 2010 as compared to 2008, which in turn, was already significantly lower than the net revenues generated in the three previous years.

BOMA & LPMA submit that net revenue generated from these activities should be maintained at the 2008 actual level of $1.4 million for each of 2009 and 2010. Hydro One has not provided any compelling evidence of the magnitude of the decreases forecast for gross revenues and the associated cost of sales. Gross revenues have been in the $18 to $22 million range in 2005 through 2008. The forecast has that level reduced to less than $5 million per year. It is submitted that the reduction in external work activity is not supported by the evidence.

ii) Secondary Land Use

As shown in Table 1 of Exhibit E1, Tab 1, Schedule 2, revenues from secondary land use have risen from $11.9 million in 2005 to $22.0 million in 2008. The forecast for 2009 and 2010, at just over $11 million, represent nearly a 50% reduction.

This revenue is associated with rental income from properties and the costs associated with this renal income are minor administrative costs (Tr. Vol. 3 pp. 72 – 73).

Hydro One has indicated that the level of revenues generated in 2006 through 2008 are "*unusually elevated due to one-time events*" (Exhibit E1, Tab 1, Schedule 2, page 3). It appears to BOMA & LPMA that these one-time events are becoming quite regular. Even ignoring the increases in 2006 through 2008, Hydro One is forecasting lower rental income in 2009 and 2010 than that recorded in 2005.

BOMA & LPMA are prepared to accept the forecasts for 2009 and 2010 as proposed by Hydro One, but only with the provision of a variance account to capture any on-going one-time revenues that would increase these revenues beyond the base level forecast. This would ensure that any of these unforecasted revenues would be to the benefit of ratepayers in the long term.

An alternative to the use of a variance account would be to increase the level of the secondary land use rental revenue in both 2009 and 2010 to the average level recorded in 2005 through 2008. This would be $16.4 million. This average reflects the probably of one-time evens in the future based on their occurrence, along with the additional revenue generated, in the recent past.

DEFERRAL AND VARIANCE ACCOUNTS

a) Planned Disposition of Regulatory Assets

i) Disposition Period

Hydro One has proposed to reduce the annual revenue requirements over a four year period by the Regulatory Asset total balance of $(18.3) million (Exhibit F1, Tab 2, Schedule 1). This would reduce the revenue requirement $2.3 million in 2009 and $4.6 million in 2010, as shown in Exhibit F2, Tab 1, Schedule 2.

Hydro One states that this proposal would maintain consistency with recovery periods approved for other Regulatory Accounts in previous Decisions (Exhibit I, Tab 2, Schedule 24, part c). In particular, Hydro One states that a four year recovery helps to smooth the customer impact.

BOMA & LPMA submit that the Regulatory Asset total balance should be used in its entirety to reduce the revenue requirement for 2009 and 2010. The increases proposed by Hydro One for 2009 and 2010 are significant. Use of these credit balances would go a long way to help reduce these proposed rate increases, and thereby smooth rates in 2009 and 2010. As shown in the response to Exhibit I, Tab 2, Schedule 24, parts a & b, the disposition over a 18 month period would result in a reduction of $6.1 million in 2009 and $12.2 million in 2010. These figures are shown in Exhibit J3.4.

Moving from the Hydro One timing proposal of four years to the 18 month period would reduce the revenue requirement in 2009 by $3.8 million and reduce the 2010 requirement by $7.6 million. BOMA & LPMA submit that this is a reasonable approach to help mitigate the impact on rates. Further, BOMA & LPMA submit that it would be inappropriate to charge customers higher rates in 2009 and 2010 while at the same time withholding funds that have arisen from overpayments in the past.

ii) 2009 Amount

It is unclear to BOMA & LPMA how Hydro One has concluded that "*In calculating rates revenue requirement for 2009 with a rate change effective July 1, 2009 the regulatory asset refund amount should be $(10.5)M for 2009*" as stated in the response to Exhibit J3.4.

As shown in the response to a Board Staff interrogatory (Exhibit I, Tab 1, Schedule 15), the amount of $(14) million shown in the original Exhibit E1, Tab 1, Schedule 1, Table 2 at line 8, the figure is $(13.5) million. This amount reflects three sets of adjustments. The first relates to the recovery of market ready project of $4.4 million, the refund of export credit revenue of $(13.2) million and the refund of regulatory assets of $(4.7). This latter figure does not appear to be consistent with the evidence in Exhibit F2, Tab 1, Schedule 2 that shows the 2009 refund related to regulatory assets of $(2.3) million.

Second it is not clear why Hydro One used the full $14 million to show a reduction in the 2009 revenue requirement, with the proposed July 1, 2009 change in rates when the response to Exhibit J3.4 now indicates that $4.4 million of this amount has been refunded to customers in the January through June, 2009 rates, leaving a lower amount to reduce the 2009 revenue requirement. It appears that Hydro One had underestimated the 2009 Rates Revenue Requirement in Table 2 in Exhibit E1, Tab 1, Schedule 1 by this $4.4 million.

BOMA & LPMA invite Hydro One to clarify both of these issues in their reply argument.

b) Tax Changes

BOMA & LPMA support the continuation of the deferral account related to tax rate changes. Mr. Cowan referred to this account, as shown in Exhibit F2, Tab 1, Schedule 1 that would be used to track any changes that could result from a tax change (Tr. Vol. 5, page 40). BOMA & LPMA further submit that the Board should make it clear that this account tracks not only changes resulting from income tax rate changes, CCA changes and capital tax changes, but any changes resulting from a legislative change, which could include harmonization of the provincial sales tax ("PST") with the goods and services tax ("GST"). This change could have a substantial reduction on OM&A costs and capital expenditure costs.

COST OF CAPITAL

a) Return on Equity

Hydro One is subject to the deemed debt/equity ratio and determination of the return on equity ("ROE") as documented in the Board's December 20, 2006 Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors. The Board found that the ROE formula as documented in that Report should apply to Hydro One for its transmission assets in the EB-2006-0501 Decision (August 16, 2007).

Hydro One was asked in a BOMA/LPMA interrogatory if the July 1, 2009 rates would be based on an ROE that was based on the March, 2009 *Consensus Forecasts* and Bank of Canada data for all business days in the month of March (Exhibit I, Tab 2, Schedule 2).

The response stated that Hydro One's ROE for 2009 would be based on the *Consensus Forecasts* and Bank of Canada data three months in advance of the effective date for the rate change.

In the response to Board Staff Interrogatory #3 (Exhibit I, Tab 1, Schedule 3) Hydro One stated:

> "*... for 2009, the Board would determine the ROE for Hydro One Transmission based upon the March 2009 Consensus Forecasts and Bank of Canada data which would be available in April 2009*".

It was unclear from this response whether the Bank of Canada data to be used was March data or April data, since both would be available in the month of April.

A similar response in Board Staff Interrogatory #3 indicated that:

> "*For rates effective January 1, 2010, the Board would determine the ROE based upon the September 2009 Consensus Forecasts and Bank of Canada data which would be available in October 2009*".

Again, this response left open the possibility that the Bank of Canada data used to set the 2010 ROE could be either the September or October, 2009 figures.

Upon cross examination, the Hydro One witnesses clarified that the Bank of Canada data to be used to set rates for July 1, 2009 would be March and for the January 1, 2010 rates, the data would be for September (Tr. Vol. 3, pg 62 – 63).

BOMA & LPMA support the determination of the 2009 ROE based on the March, 2009 *Consensus Forecasts* and Bank of Canada data for the month of March. BOMA & LPMA also support the determination of the 2010 ROE based on the September, 2009 *Consensus Forecasts* and Bank of Canada data for September.

The December, 2006 Cost of Capital Report clearly states (in Appendix B) that the final ROE would be based on the Long Canada Bond forecast based on the *Consensus*

Forecasts and Bank of Canada data three months in advance of the effective date for the rate change.

BOMA & LPMA submit that the proposal, as clarified by Hydro One during the oral hearing, is in compliance with the Cost of Capital Report and should be accepted by the Board.

BOMA & LPMA submit that the Board should issue a letter, similar to its February 24, 2009 letter re **Cost of Capital Parameter Updates for 2009 Cost of Service Application** that shows the cost of capital parameters, include ROE, that will apply to Hydro One in 2009 based on the March data when it is available. The Board should then issue another letter in the fall when the September data is available that will show the cost of capital parameters applicable to Hydro One for 2010.

b) Short Term Debt Rate

Hydro One's proposal for the short term debt rate used in the calculation of the cost of capital for 2009 and 2010 is consistent with the Board's Cost of Capital Report. In particular, when asked if the short term debt rate should be calculated as the average of the 3-month bankers acceptance rate plus a fixed spread of 25 basis points, as published on the Bank of Canada's website for all business days of the same month as used for determining the ROE, Hydro One confirmed this approach (Exhibit I, Tab 2, Schedule 3).

BOMA & LPMA support this proposal, as it is in compliance with the Board's Cost of Capital Report.

c) Long Term Debt Rate

The long term debt rate as calculated by Hydro One is impacted by the three sets of numbers. The first is the rate associated with third party long term debt. The second is the rate applicable to the deemed long term debt. The third is the Treasury OM&A costs. Each of these is dealt with below.

i) Third Party Long Term Debt

The calculation of the weighted average cost associated with the third party long term debt for the 2009 and 2010 test years is shown in Exhibit B2, Tab 1, Schedule 2, pages 5 & 6. The total cost for 2009 is $220.4 million with an average embedded cost rate of 5.9031%. The carrying cost for 2010 is $248.5 million with an average embedded cost rate of 5.014%.

BOMA & LPMA agree with this calculation of the embedded cost rates with the exception noted below.

Hydro One does not propose to update the forecast of interest rates for the 2009 or 2010 issues planned. Mr. Cowan confirmed that Hydro One was not asking to update the costs associated with their third party debt (Tr. Vol. 5, page 32). BOMA & LPMA support this position. As shown in comparing the forecast of rates in Table 4 of Exhibit B1, Tab 2, Schedule 1 with that provided based on updated information in the response to Undertaking J3.1, there is not a significant net change in the rates. In 2009, 5 year rates are virtually unchanged, while the 10 and 30 year rates are up slightly. In 2010, the rates for all the issuance terms are down from that forecast but again the changes are only marginal. Based on the limited impact these changes would have, BOMA & LPMA submit that the Board should accept Hydro One's proposal to not update the forecast of the rates associated with debt forecast to be issued in either 2009 or 2010.

The exception noted above is related to the cost of third party long term debt issued in 2008. As stated in Exhibit B1, Tab 2, Schedule 1 on page 4 and shown in Table 2 of that Exhibit, the original evidence presented by Hydro One included a forecasted amount of $191.1 million to be issued in 2008 at a forecasted debt rate of 5.47% for a 30 year term.

The February 13, 2009 Update to Exhibit B2, Tab 1, Schedule 2, page 4 continues to show this amount at the 5.47% as the September 15, 2008 issue shown on line 25. However, this is unchanged from the original version of this schedule. It appears that the updated schedule has only been updated to reflect the actual treasury OM&A costs and other financing-related fees shown on lines 27 and 28.

As shown in the response to BOMA/LPMA Interrogatory #20 (Exhibit I, Tab 2, Schedule 20), however, there were significant deviations from the forecast in the term, amount and interest rate associated with this debt. In particular, the total amount of debt issued was $300 million instead of $191.1 million. The terms are significantly shorter at 2 and 5 years rather than the 30 year forecast. Finally, the rates associated with the debt actually issued are 5.00% and 3.89%, with a weighted average cost of 4.78%, which is significantly lower than the 5.47% coupon rate shown in Table 2.

BOMA & LPMA submit that the Board should take the actual debt issued in 2008 into account when establishing the amount of debt to be added in 2009 and 2010 and the resulting embedded debt rate. The reduction in the actual weighted debt rate from that forecast for the $191.1 million issue in 2008 is 0.69%. This translates into a reduction in interest cost on the $191.1 million of approximately $1.3 million per year. BOMA & LPMA submit that this reduction should be reflected in the calculation of the average embedded cost rates for 2009 and 2010.

Further, it appears that Hydro One issued nearly $110 million more than that forecast for September, 2008 ($300 million vs. $191.1 million). It is not clear to BOMA & LPMA if the $300 million shown in Exhibit I, Tab 2, Schedule 20 was all mapped to Hydro One Transmission. BOMA & LPMA invite Hydro One to clarify this in their Reply Argument.

If the full $300 million shown in Exhibit I, Tab 2, Schedule 20 has been mapped to Hydro One Transmission in place of the $191.1 million forecast, then BOMA & LPMA submit that there should be a reduction the amount of debt to be added in 2009 by the same amount. Further this reduction should come from the planned 30 year issue, since it is the most costly in terms of the rate.

ii) Deemed Long Term Debt

As shown in Table 1 of Exhibit B1, Tab 1, Schedule 1 and explained on page 3 of that Exhibit, Hydro One has deemed long term debt of $205.8 million in 2009 and $0.3 million in 2010. The evidence states that this amount consists of any affiliate debt that is callable on demand as well as the remaining amount of the long term debt required to balance the total financing with the rate base.

However, as shown in the response to VECC Interrogatory #25 (Exhibit I, Tab 6, Schedule 25), the truth is that all of the deemed long term debt for both 2009 ($205.8 million) and 2010 ($0.3 million) is the remaining amount of debt required to balance the total financing with rate base. <u>There is no affiliate debt that is callable on demand included in this amount.</u>

Hydro One proposes to apply the deemed long term debt rate as calculated by the Board to this deemed long term debt. This debt rate has been determined by the Board to be 7.62% in its February 24, 2009 letter related to the Cost of Capital Parameters and attached to the response to Undertaking J5.2 in this proceeding. Consistent with the ROE and short term debt rate, Hydro One proposes to use the deemed long term debt rate as calculated by the Board using March data for 2009 rates and using September data for 2010 rates.

Hydro One claims that the application of this rate to deemed long term debt is consistent with the Board's Cost of Capital Report (Exhibit B1, Tab 1, Schedule 1, page 3).

BOMA & LPMA respectfully disagree.

A review of the December 20, 2006 Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors shows that there is no mention of "deemed long term debt". There are only references to the "deemed long term debt **<u>rate</u>**".

In particular, the Board Report clearly indicates that the lower of the contracted rate or the deemed long term debt rate would be used for new affiliated debt. The Board Report also states that the deemed long term debt rate would be used for all variable rate debt and for all affiliate debt that is callable on demand.

As noted in the response to VECC at Exhibit I, Tab 6, Schedule 25, Hydro One confirms that it has no affiliate debt. There is also no variable rate debt shown in the capital structure of Hydro One as the debt in question is deemed debt – it does not actually exist.

BOMA & LPMA further note that in the various distribution rate rebasing applications for 2008 and 2009, the weighted average cost of actual third party debt and actual affiliate and variable rate debt has been used to calculate the total cost of long term debt. This has been done by applying to the weighted average cost of the long term debt to the total deemed amount of long term debt in the capital structure. The weighted average cost of long term debt does not included unfunded or balancing long term debt at the deemed long term debt rate. This means that the average cost of the long term debt (third party and affiliate and variable) in place or forecast to be in place is actually used for the unfunded or balancing debt needed to balance the capital structure.

BOMA & LPMA therefore submit that the average embedded cost rates calculated for 2009 and 2010 shown in Exhibit B2, Tab 1, Schedule 2 (with adjustments as argued elsewhere in this submission) should be used for the unfunded long term debt. In particular, the cost rate shown in Table 1 of Exhibit B1, Tab 1, Schedule 1 for the Deemed long-term debt should be the same as for the Long-term debt shown in the table. This would have little impact on the 2010 interest expense, but would reduce the 2009 interest expense by approximately $0.6 million.

iii) Treasury OM&A Costs

Treasury OM&A costs are shown at the bottom of the schedules found in Exhibit B2, Tab 1, Schedule 2. These costs were $1.3 million 2005, $1.4 million in 2006, $1.4 million in

2007 and $1.5 million in 2008. This latter figure is an actual cost and is shown in the February 13, 2009 Update to Exhibit B2, Tab 1, Schedule 2, page 4.

Hydro One is forecasting treasury OM&A costs to be $1.9 million in 2009 and $2.0 million in 2010. BOMA & LPMA submit these forecasts are too high and should be reduced by $0.4 million in both years.

The increases are substantial if viewed on a percentage basis. The 2009 increase from the actually 2008 level is more than 26%. The increase in 2010 from the 2008 level is 33%.

Mr. Innis explained that these costs relate to the treasury administration fees and are related to general increases due to escalation of wages because these costs are primarily wage costs (Tr. Vol. 3, page 64 – 65), including some general administrative support.

BOMA & LPMA submit that costs that are primarily wage costs should not be increase by more than 26% in 2009. A reduction of $0.4 million in 2009 to $1.6 million still reflects a healthy increase of more than 6% in 2009.

iv)Summary

In summary, BOMA & LPMA submit that the costs associated with long term debt should be reduced by $2.3 million in 2009 ($1.3 for 2008 actual debt issuance, $0.6 for deemed debt, $0.4 for treasury) and $1.7 million in 2010 ($1.3 for 2008 actual debt issuance, $0.4 for treasury). Any further reductions in 2009 in 2010 related to the $300 million issuance in 2008 in place of the $191.1 million forecast would be in addition to these reductions.

COST ALLOCATION & RATE DESIGN (AMPCO)

The Association of Major Power Consumers in Ontario (AMPCO) has proposed a significant change in the design of rates that allocates transmission costs to customers.

While empirically appealing, BOMA & LPMA submit that more review is required before any changes are made. Further review is needed to explore a number of potential issues that may arise from this proposal.

Of most concern to BOMA & LPMA is the impact that the proposal may have on the allocation of costs to other customers including distributors. These costs are ultimately passed through by the distributors to their ratepayers.

Customers of distributors should be provided with the same incentive and opportunity to reduce their transmission related costs. However, under current distribution rate design this is not possible.

BOMA & LPMA submit that if the Board determines that the AMPCO proposal should be accepted, or studied further, that it should also tie into this proposal the potential for rate design changes at the distributor level related to the pass through of the transmission costs. All customers, not just those served directly by transmission, should have the same incentive and opportunity to reduce their transmission costs. If all customers could take advantage of the AMPCO proposal, then the positive benefits described by AMPCO would be even larger.

BOMA & LPMA submit that if the Board wishes to pursue the AMPCO proposal or decide that it should or could be implemented at some future point, then it should implement a review of the allocation of the transmission costs by distributors to their customers to ensure that those customers are treated fairly and equitably with respect to the transmission costs.

COSTS

BOMA & LPMA request that they be awarded 100% of their reasonably incurred costs. The consultant to BOMA & LPMA worked with other intervenors to ensure that all the issues were adequately covered through the interrogatory process and the oral hearing.

Attendance at the oral hearing was limited to the panel for which cross examination to clarify a number of issues was required.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

March 20, 2009

Randy Aiken

Randy Aiken

Consultant to BOMA & LPMA