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March 24, 2009

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
27th floor
Toronto ON M4P 1E4

Dear Ms Walli,

Hydro One Networks Inc. ("Hydro One")
Transmission Rate Case
Board File No.: EB-2008-0272
Our File No.: 339583-000027

Hydro One representatives informed me this morning that there are a few redactions that need to be made to the version of the Written Argument of Canadian Manufacturers & Exporters ("CME") which is to be filed on the public record.

We therefore attach and are filing with the Board electronically the Redacted Version of CME's Written Argument. The only redactions in the document are from the Table which appears in paragraph 13 on page 4 of the Argument.

Confidential Unredacted copies of the document will be forwarded to the Board by courier.

Please contact me if there are any questions about this.

Yours very truly,

Peter C.P. Thompson, Q.C.

PCT\slc
enclosure
c. Glen MacDonald (Hydro One)
Interested Parties
Paul Clipsham (CME)

OTT01\3683205\1

EB-2008-0272

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.

REDACTED
ARGUMENT OF
CANADIAN MANUFACTURERS & EXPORTERS ("CME")

March 23, 2009

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A. Overview

1. Ontario, Canada and the rest of the world are in the midst of a severe recession. Ontario manufacturers have been particularly hard hit.

2. For Ontario manufacturers, the primary issue in this case is whether the 2009 and 2010 transmission spending plans of Hydro One Networks Inc. ("Hydro One") are sufficiently responsive to the severe economic turmoil in which we are immersed.

3. Regulation is often stated to be a "surrogate for competition". In setting rates, regulators, as the surrogate for competition, should strive to emulate a competitive market outcome.

4. In recessionary times, competitive market participants constrain capital and operating spending to the maximum extent possible. In a severe recession, infrastructure spending is largely funded by governments and not by competitive market participants and their customers. In recessionary times, utilities should behave similarly. They should constrain spending plans, as much as they can, without impairing the provision of safe and reliable service to their existing customers.

5. In the midst of a severe recession, utility regulators should scrutinize utility spending plans to determine whether they reflect an appropriate recession-related degree of constraint. Affordability considerations should take priority in recessionary times.

6. For reasons which follow, Canadian Manufacturers & Exporters ("CME") submits that Hydro One's 2009 and 2010 Transmission spending plans do not reflect an appropriate recession-related degree of constraint. Hydro One's evidence fails to

convincingly demonstrate that the large increases in capital and operating spending budgeted for 2009 and 2010 are reasonable in these recessionary times. The consequential increases in the Transmission Rates Revenue Requirement for 2009 and 2010 should not be approved. Ontario Energy Board (the "Board") approved 2009 and 2010 Transmission Rates for Hydro One should be based on materially lower Rates Revenue Requirement amounts for each of those years.

B. Rationale for Requiring Recession-Related Spending Constraints

7. The regulatory rationale for requiring recession-related budgeting constraints includes the above-noted obligation of regulators, as surrogates for competition, to emulate a competitive market outcome, as well as the obligation of utilities to minimize rate shock. Hydro One acknowledges this obligation.[1]

8. In a severe recession, the obligation of the utility to mitigate rate shock calls for material constraints in planned spending because, in recessionary times, any rate increases produces a shock which has the potential of triggering an electricity consumer "death spiral". The statutory objective which requires the Board to protect the interests of electricity consumers[2] is a matter of increased importance when electricity consumers find themselves in the midst of a severe recession.

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1 Hydro One Argument-in-Chief, Transcript Volume 7, page 3, lines 17 to 21
2 *Ontario Energy Board Act*, Section 1

9. The rationale for requiring recession-related spending constraints is not based on the proposition that the Board should suppress the rates of the Government owned utilities it regulates to achieve a public policy objective, as counsel for Hydro One suggested in his Argument-in-Chief.[3]

10. The examination of witnesses at the hearing of the extent to which Hydro One's revenue requirement consists of profit and notional taxes which flow to its owner, the Province of Ontario, was prompted by evidence from a Hydro One witness suggesting that Hydro One's Board of Directors had approved a 2009 Budget which included a profit element in an amount less than the then Board approved Return on Equity ("ROE")[4]. The witness later clarified that the 2009 Budget approved by the Board of Directors in November 2008 did not reflect a conscious decision of the Directors to plan for a loss of profit.[5]

11. The requirement for recession-related constraints in Hydro One's 2009 and 2010 spending plans is particularly acute when one considers the series of Hydro One transmission and distribution rate increases which electricity consumers have experienced in recent years, and the extent to which Hydro One is planning transmission and distribution rate increases for the years 2009 to 2011 inclusive.

12. The transmission and distribution rate increases which the Board approved for Hydro One for the years 2006, 2007 and 2008 are a matter of record.[6] For some distribution customers, whose rates are currently be harmonized with rates being

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[3] Transcript Volume 7, page 3, lines 5 to 16

[4] Transcript Volume 3, page 125, line 19 to page 126, line 13, and page 127, line 15 to page 128, line 14; see also paras. 53 and 54 of this Argument

[5] Transcript Volume 4, page 4, line 13 to page 6, line 4

[6] EB-2006-0501 Decision with Reasons, August 16, 2007

paid by other Hydro One customers, the distribution rate increases for 2008 and years following have been and will be very significant.[7]

13. The evidence in this case[8] indicates that the transmission and distribution rate increases Hydro One is planning for the years 2009 to 2011 inclusive are as follows:

Year over Year	Transmission	Distribution
2009 over 2008	6.4%	4.0%
2010 over 2009	12.1%	**[REDACTED]**
2011 over 2010	10.7%	**[REDACTED]**
Totals	**29.2%**	**[REDACTED]**

14. Successive transmission and distribution rate increases of this magnitude, in combination with the ever-increasing costs being passed on to electricity consumers through the "Global Adjustment", impair the already tarnished attractiveness of Ontario as a place for manufacturers to continue to conduct their businesses. Recession-related spending constraints are required of Hydro One and the other utilities the Board regulates to help prevent any further shrinkage of the energy dependent manufacturing sector in Ontario.

15. Absent recognition by the Board of the need for utilities to reflect appropriate spending constraints in their budgets, then, over the longer term, Ontario is unlikely to remain as a place where energy dependent manufacturers will continue to conduct their businesses. If the Board does not set some limits on the ever-increasing spending plans of Hydro One, then energy dependent

7 EB-2007-0681 Decision with Reasons, December 18, 2008, page 43. For some distribution customers, the distribution rate increases are so large that they are being phased in over four (4) years in order to limit their total bill impacts to 10% in 2008, 8% in 2009 and 7% in 2010.

8 Exhibit KX3.5 and Hydro One's January 30, 2009 Application in EB-2008-0187 at para. 3 of Exhibit A, Tab 2, Schedule 1 of the EB-2008-0187 filing

manufacturers in Ontario are likely to find themselves "out of their markets". If this scenario emerges, then Ontario's unattractiveness to energy dependent manufacturers will prevail until such time as the Ontario Government begins to off-set the ever-increasing prices of electricity by waiving some or all of the revenues it currently recovers from electricity consumers through their payments on account of stranded debt and through the profit and Payment-in-Lieu of Taxes ("PILs") components of their regulated rates.

16. We recognize that the Board is not empowered to provide electricity consumers with relief from the material portion of their bills that relates to stranded debt payments, profit, and PILs. However, the Board is empowered to determine rates for Hydro One on the basis of budgets which reflect a recession-related degree of constraint considered by the Board to be appropriate. For reasons which follow, we submit that the Board should exercise this power by directing Hydro One to design its rates on the basis of materially reduced 2009 and 2010 Capital and Operating Spending Plans.

C. Indicators of Unreasonableness in Hydro One's 2009 and 2010 Budgets

(i) Incompatibility of Capital Spending with Historic Norms

17. The Board has emphasized, in prior decisions, that utility spending plans need to be compatible with historical spending norms. In its Decision with Reasons dated February 9, 2006, in EB-2005-0051 on an application for approval of rates made by Enbridge Gas Distribution Inc. ("EGD"), the Board stated as follows:

> *"The Board's role is to ensure that Enbridge's total spending program is balanced in that it is not so low as to threaten the orderly maintenance and development of the system, nor so high as to place undue upward pressure on rates, either in the test year or some future. In fulfilling this role, the Board attempts to place the capital spending plans within historical norms, which can be presumed to have found that appropriate balance. If spending well in excess of historic norms is proposed, the Board must assess whether the increase is justified through the presentation of evidence regarding the Company's analysis, prioritization, and judgment respecting budget components."* [9]

18. The compatibility of budgeted amounts with historic spending norms is examined from a number of perspectives, including line-by-line and global amount comparisons to bridge and historic year amounts and averages thereof. Global amount comparisons reflect the aggregate of line-by-line variances and, in our submission, comprise sound evidence on which to base findings with respect to the issue.

19. In placing EGD's capital spending plans within the limits of historic norms in the EB-2005-0051 proceeding, the Board based its finding that EGD's 2006 capital budget was incompatible with historic norms by comparing it to the average capital expenditures for the prior five (5) years. The Board approved a capital budget for EGD which was equivalent to the average for the prior five (5) years, plus an additional amount of $50M (being 20% of the five year average) to provide for the contingencies suggested by EGD in its evidence and general inflationary pressures.

20. We calculate the five (5) year capital expenditures total for Hydro One for the years 2004 to 2008 inclusive to be $2,466.2M or, on average, about $489.24M per year. We have derived this amount by using the capital expenditure amounts

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[9] Exhibit K1.4

in Table 4 of the Board's Decision with Reasons in EB-2006-0510 dated August 16, 2007, for the years 2004 to 2006 inclusive of $431.9M, $349.2M and $401.4M respectively, and adding to them Hydro One's actual transmission related capital expenditures for 2007 and 2008 of $559.5M and $704.2M respectively. We submit that this is one of the historic norms which the Board should consider when evaluating the reasonableness of Hydro One's 2009 and 2010 Capital Spending Plans.

21. The influence of historic capital under-spending on the extent to which budgeted increases will be approved was addressed by the Board in its Decision with Reasons dated August 16, 2007, in EB-2006-0501, being Hydro One's Application for Approval of 2007 and 2008 Electricity Transmission Revenue Requirements. There, when rejecting a proposal by Vulnerable Energy Consumers Coalition ("VECC"), that an Earnings Sharing Mechanism ("ESM") be established to guard against the adverse impacts on ratepayers of capital under-spending, the Board stated as follows:

> *"… the Board expects Hydro One to file a Cost of Service Application for 2009 Rates. At that time, the Board expects Hydro One to provide evidence on 2007 and 2008 actual capital spending compared to the Board approved budget. <u>Future decisions on capital budgets will be informed by Hydro One's performance to plan</u>."* (emphasis added)

22. Hydro One's actual capital spending for 2007 of $559.5M was $152.1M or 21% <u>below</u> the Board approved capital budget of $711.6M. For 2008, Hydro One's actual capital under-spending of $704.2M was $70.2M <u>below</u> the Board approved

capital budget of $774.4M.[10] On average, Hydro One's actual capital under-spending for 2007 and 2008 was about $111.7M per year.

23. Despite this actual under-spending in 2007 and 2008, Hydro One is budgeting capital expenditures for 2009 of about $944M, which is an amount of some $240M, or 35%, above its actual level of capital spending in 2008. For 2010, Hydro One is asking the Board to approve a capital budget of about $1,074M, some $370M, or about 53%, above its actual level of capital spending in 2008 of about $704M.[11]

24. We use global budget amounts as the basis for conducting a compatibility with historic norms assessments as the primary tool for measuring reasonableness, with line-by-line comparisons as the secondary source of comparators because, as noted above, the global amounts reflect the aggregate of the line-by-line variances.

25. Measured against the 2008 Board approved capital budget of about $774M, the 2009 capital budget of about $944M is about $170M, or some 22% over the 2008 Board approved budget amount. For 2010, the capital budget amount of about $1,074M is some $300M, or 39%, above the 2008 Board approved capital budget amount.

26. If the approach applied by the Board in the EGD case is followed, a capital budget for Hydro One, which would be compatible with historic norms, would be about 120% of the five (5) year average capital spending of $490M or an amount

[10] Exhibit K1.6. As Board Staff notes in their submissions, one of the reasons for the significant capital under-spending in 2008 is Hydro One's inability to complete work at a faster pace. This situation, in and of itself, should prompt the Board to question the reasonableness of the budgets of $944M and $1,074M for 2009 and 2010.

[11] Exhibit K1.6

of about $588M. Measured against this standard, Hydro One's 2009 capital budget of $944M is 160% of the historic norm. The 2010 capital budget is about 183% of the historic norm.

27. The capital budget amounts Hydro One asks the Board to approve for 2009 and 2010 are incompatible with these historic norms. In the context of the Board's finding in Hydro One's last transmission rates application, that "future decisions on capital budgets will be informed by Hydro One's performance to plan", these facts, in and of themselves, should prompt the Board to question the reasonableness of Hydro One's 2009 and 2010 capital spending plans.

(ii) Large Increases in Operating Maintenance and Administration ("OM&A") Expenses Over Historic Norms

28. Hydro One's actual OM&A spending levels, for 2007, of $412.9M and, for 2008, of $373.8M represents an average amount of $393.35M and compare to the Board approved amounts of $394.1M, for 2007, and $387.5M, for 2008, respectively for an average Board approved amount of about $390.8M.[12] The 2008 actual OM&A expenses were some $35M lower than actual 2007 expenses. As well, actual 2008 OM&A expenses of $373.8M were about $29M lower than the amount of $402.8M forecast by Hydro One in its initial September 2008 evidence.[13] These material declines in bridge year expenses are an important component of the historic norm evidence to be considered when

[12] Once again, for reasons already noted, we primarily rely on the global OM&A amounts as the basis for measuring departures from historic norms.
[13] Exhibit K2.4

evaluating the reasonableness of the OM&A expenses Hydro One asks the Board to approve for 2009 and 2010.

29. The total OM&A expense amount which Hydro One asks the Board to approve for 2009 is $435M. This amount materially exceeds the actual 2008 OM&A expenditures of $378.8M, the average actual expenditures for 2007 and 2008 of about $393M, and the bridge year Board approved OM&A expenses of $387.5M. The 2009 OM&A expenses budget is $435M, some $61.2M or about 16.4% above 2008 expenditures of $373.8M.[14] The 2009 budget is some $42M, or 10.6%, above the average actual expenditures for 2007 and 2008. For 2010, Hydro One asks the Board to approve OM&A expenses of $449M, being an increase of $56M, or about 14%, over and above the average 2007 and 2008 OM&A expenditures.

30. At a time when inflation for the test period is now expected to be considerably less than the rate of 2.3% for 2009 and 2.0% for 2010[15] assumed by Hydro One, the level of OM&A increases requested by Hydro One, on their face, are incompatible with the 2007 and 2008 average OM&A expenses historic norm.

(iii) <u>Hydro One's Budgeting Process</u>

31. The sheer magnitude of Hydro One's budgeted increases in capital and operating spending for 2009 and 2010 prompted counsel for CME to question Hydro One's business planning and budgeting process.

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14 Exhibit K2.4

15 Exhibit A, Tab 14, Schedule 1, Appendix A, page 1

32. In evidence, Hydro One witnesses asserted that the Company's capital and operating budgets are the result of a "rigorous business planning … process".[16] Hydro One witnesses acknowledge that, for a business planning process to be rigorous, it should be responsive to emerging trends in factors affecting spending plans, including the following:

    (a) changes in actual historic spending which is the foundation upon which the budgeted spending plans are formulated;

    (b) inflation and other business planning assumptions; and

    (c) economic circumstances affecting the ability of consumers to pay increased prices for the services to be provided.[17]

33. The fact that actual capital and operating spending in 2008 emerged in amounts considerably less than anticipated, when the Board of Directors approved Hydro One's 2009 to 2011 Business Plan in August 2008, did not lead to any reductions to the 2009 and 2010 spending plans in November 2008 when the Board of Directors approved the 2009 Budget and the Outlook for 2010 and 2011. Material changes in the forecasts of economic indicators between August and November 2008 such as a materially reduced forecast of the rate of inflation for 2009 and years beyond did not lead to any reductions in 2009 and 2010 spending plans.

34. The emergence of the severe recession between August and November 2008 did not prompt Hydro One management to introduce or the Board of Directors to

[16] Transcript Volume 2, page 133, line 26 to page 138, line 18;
Transcript Volume 3, page 76, line 20 to page 77, line 3

[17] Transcript Volume 2, page 137, line 6 to page 138, line 18

require any measures to reduce the burden on ratepayers. The only planning changes made between August and November 2008 had the effect of increasing, rather than reducing, the rate increase burden on ratepayers in 2009.[18]

35. The evidence at the hearing reveals that Hydro One's budgeting process is not responsive to emerging trends with respect to actual spending, inflation and other business planning assumptions, or economic circumstances effecting the ability of consumers to pay increased prices for the services to be provided.

36. In its application, the planning and budgeting process is rigid and rigid to the point of intransigence in that, the Company refuses to engage in settlement discussions with intervenors which are premised on the use of reduced spending plans to derive test period rates.[19]

37. We submit that the evidence demonstrates that Hydro One is insensitive to the ability of ratepayers to cope with year-after-year increases in the cost of transmitting and distributing electricity. Despite the onset of the recession, the incurrence of actual capital expenditures in amounts far less than the Board approved amounts, and material changes in economic indicators, including inflation, Hydro One did nothing in November 2008 to relieve the burden on ratepayers of the 2009 and 2010 spending plans its Board of Directors approved

[18] Exhibit I, Tab 4, Schedule 2 Confidential; Exhibits KX3.4 and KX3.5
Transcript Volume 4, page 6, line 5 to page 21, line 23, and in particular, at page 10, line 7 to page 12, line 25. The fact that the transmission budget did not change between August and November 2008 does not alter the reality that the Hydro One Directors acted in November and subsequently to increase rather than decrease the burden on ratepayers.

[19] Transcript Volume 2, page 154, line 9 to page 155, line 19; Hydro One's January 16, 2009 letter which states as follows: *"… the Company will not commit to any reduction to either the capital or OM&A expenditures requested for the test years 2009 and 2010."*

in August 2008. In fact, it acted to increase, rather than decrease, this burden. Affordability considerations did not come into play in November 2008.

(iv) No Mitigation of Burden on Ratepayers – No Recession-Related Constraints in Hydro One's Spending Plans

38. In accordance with its acknowledged obligation to mitigate rate shock,[20] the emergence between August and November 2008, of the severity of the recession, along with material changes in other economic indicators, should have prompted Hydro One to introduce recession-related constraints in its 2009 and 2010 spending plans in order to relieve the rate increase burden on ratepayers of its August 2008 plans. Despite suggestions that it introduced measures to mitigate and relieve the burden of its August 2008 spending plans on ratepayers, Hydro One did not, in fact, change its plans between August and November 2008 and after November, to reduce the burden of August 2008 plans on ratepayers. Its November 2008 plans contain no mitigative measures and no recession-related constraints. The evidence with respect to these points is summarized in the paragraphs which follow.

39. The milestones applicable to business planning and budgeting are set out in Exhibit A, Tab 14, Schedule 1, page 2 as follows:

Date	Action
January 2008	Strategic direction and goals established by Senior Management
January 2008	Business Plan instructions issued
February 2008	Investment proposals developed
April/May 2008	Investment plan prioritized and selected
June 2008	Executive Committee review of business plans with Lines of Business
August 2008	Hydro One Inc. Board approval of business plan

[20] See Footnote 1

40. The business planning process led to an initial Capital Spending Plans for 2009 and 2010 of $1,529M and $1,287M respectively.[21] The initial 2009 Capital Spending Plan of $1,529M is more than two (2) times Hydro One's actual 2008 Capital Spending of about $704M and almost two (2) times the 2008 Board approved Capital Budget of $774M.

41. The initial transmission OM&A Spending Plans for 2009 and 2010 were $428M and $424M respectively,[22] which compares to the average OM&A expenses incurred by Hydro One in 2007 and 2008 of about $393M per annum.

42. Considerations of risk influence the development by Hydro One of its Capital and OM&A Spending Plans, although they are not determinative of the final amounts either approved or spent in any particular year.[23]

43. Hydro One's initial Capital Spending Plan for 2009, presented in April of 2008, of some $1,529B and of $1,287M for 2010 exceeded its estimates of the "minimum level" of Capital Spending for 2009 and 2010 of $1,180M and $883M respectively by amounts of about $349M for 2009 and about $404M for 2010.[24]

44. Hydro One's initial presentation of transmission OM&A expenses for 2009 and 2010 of $428M and $424M respectively exceeded its 2009 estimated "minimum levels" of such expenses, shown in Exhibit J2.7 of $377.5 for 2009 and $396.8M

[21] Exhibit K3.2
[22] Exhibit K3.2
[23] Exhibit K3.2 and Transcript Volume 3, page 86, line 4 to page 95, line 15, and page 113, line 25 to page 124, line 18
[24] Exhibit K3.2

for 2010 for a considerably reduced Capital Budget program, by some $50M for 2009 and by some $27M for 2010.[25]

45. The presentation of these Capital and Operating Spending Plans met with resistance at the April 17, 2008 Planning Meeting. By May 6, 2008, some three (3) weeks after the April 17, 2008 Planning Meeting, the initial Capital Budget had been reduced by more than $500M to $1,011M for 2009, and by more than $250M to $1,036M for 2010.[26] The rigor of the initial planning process is questionable when more than $500M of expenditures can be eliminated from the plan within three (3) weeks of its initial presentation.

46. OM&A expenses rose to $453M for 2009 and $444M for 2010 primarily as a result of the removal of more than $500M of previously planned capital expenditures.[27]

47. Further fine-tuning led to final 2009 and 2010 Capital Spending Plans for presentation to the Board of Directors on August 14, 2008, of $944M and $1,074M respectively, and final Transmission OM&A costs of about $435M and $450M for 2009 and 2010 respectively.[28]

48. The final transmission Capital Spending Plan for 2009 of $944M is about $236M less than the "minimum level" of estimated by Hydro One of $1,180M. For 2010, the Capital Spending Plan of $1,074M exceeds the "minimum level" estimated by Hydro One of $883M by about $191M.[29]

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25 Exhibit K3.2
26 Exhibit K3.2
27 Exhibit K3.2 and Transcript Volume 3, page 94, lines 17 to 24
28 Exhibit K3.2
29 Exhibit J2.7

49. The planned transmission OM&A for 2009 and 2010 of about $435M and $450M respectively exceed Hydro One's "minimum level" estimates by about $58M and $53M for 2009 and 2010 respectively.

50. These plans became the basis for the 2009 to 2011 Business Plan presentation to Hydro One's Board of Directors in August 2008. Information in the material presented to the Board of Directors in August 2008 estimated Transmission Rate increases of 6.5% in 2009 and 12.7% in 2010 and Distribution Rate increases in 2009 and 2010 in an amount of about 1% per annum based on the Board's 3rd Generation Incentive Regulation Mechanism ("3GIRM"). The information presented in August indicated that a combined Transmission and Distribution Revenue Requirement Rate Application would be made in August requesting a rate increase of about 10.7% for Transmission and 16.9% for Distribution. On these assumptions, Hydro One's profits were anticipated to be at or above the Board approved ROE.[30] Hydro One's Board of Directors' approval in August of the 2009 to 2011 Business Plan led to November 2008 presentation of the 2009 Corporate Budget and the 2010/2011 Outlook.

51. By November 2008, the depth and extent of the recession was known and 3rd Quarter estimates of Hydro One's actual Capital and Operating Expenses for 2008 were materially lower than presented in earlier quarters.[31] Yet, the only change in plans between August and November 2008 reflected in the Budget and Outlook then presented was a modification to the August 2008 Plan to seek

[30] Exhibit KX3.4
[31] Transcript Volume 3, page 96, line 22 to page 98, line 19

2009 and 2010 distribution rate increases under the Board's 3GIRM Model. Instead, by November 2008, Hydro One management had decided to seek a Cost of Service Re-Basing for distribution in 2010 as well as 2011. As a result of this change in Plans, the estimated rate increase for 2010 rose from about 1% in the August 2008 Plan to about 8% in the November 2008 Budget and Outlook. This change in Plans also increased Hydro One's profit estimates. The November 2008 Budget and Outlook showed increased earnings and profit for Hydro One in 2009 and in years following, compared to the August 2008 Plan.[32]

52. During the course of the hearing, one of Hydro One's witnesses initially suggested that, in November 2008, the Hydro One Board of Directors had taken a conscious decision to plan for a loss of profit.[33] This testimony arose during the cross-examination of the witness on the materials presented to the Hydro One Board of Directors in August and November 2008. In his testimony, the witness emphasized that the material the Board of Directors considers pertains to the Company as a whole and is not confined in scope to the Transmission business.[34]

53. In later testimony, the Hydro One witness clarified that he did not intend to suggest that the Directors had consciously planned for a loss of profit. Rather, what was being suggested was that Hydro One's Directors in November 2008

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[32] Exhibit KX3.5

[33] Transcript Volume 3, page 124, line 19 to page 126, line 13;
Transcript Volume 4, page 5, line 4 to page 6, line 4;
Transcript Volume 4, page 8, line 11 to page 21, line 23

[34] See para. 11 of this Argument and footnotes 4 and 5. The questions which were asked of the witness related to the plans of the Company as a whole and the evidence at Transcript Volume 4, page 4, line 3 to page 5, line 23 reveals that the witness understood the questions in this context, which he emphasized again at Transcript Volume 4, page 6, line 27 to page 7, line 17.

had consciously done nothing between the August 2008 Plan and the November Budget and Outlook of 2008 to increase the burden on Hydro One's ratepayers.[35]

54. The increased profitability reflected in the November 2008 Budget and Outlook, compared to the August 2008 Plan, discredits the witness's contention that Hydro One Directors in November 2008 did nothing to increase the burden on Hydro One's ratepayers.[36]

55. The notion that Hydro One is acutely sensitive to the difficulties that its ratepayers will have in coping with any rate increases as a result of the severe recession in which they are immersed is also discredited by the fact that between November 2008 and January 30, 2009, Hydro One again changed its Plans and filed an update to its 3GIRM Application in which it requested approval of an additional $21.3M of revenue requirement under the auspices of the incremental capital module in the Board's 3GIRM Model.[37]

56. The 2009 Budget and 2010/2011 Outlook approved by Hydro One's Board of Directors in November 2008 reflects the then planning decision not to include a capital adjustment request in its 3GIRM Distribution Rate Application. The November Budget and Outlook reflects a distribution rate adjustment of approximately 1% effective May 1, 2009, based on the 3GIRM Model. The Budget and Outlook approved by the Directors in November 2008 also recognizes that a decision to refrain from updating load forecasts could have an

[35] See footnotes 18 and 34
[36] Exhibit KX3.5; Transcript Volume 4, page 9, line 17 to page 10, line 18
[37] See footnote 7

impact on the Company as a whole of $17M in a "economic downturn" scenario and $20M in a "deep recession" scenario.[38]

57. By changing its Plans between November 2008 and January 30, 2009, to seek an additional $21.3M of revenue from its distribution customers, Hydro One not only acted to materially increase the burden on electricity ratepayers, it also acted to insulate itself from the $17M to $20M of load loss risk identified in the 2009 Budget and Outlook.[39]

58. Once again, Hydro One's planning decisions, made since the onset of the severe recession became apparent, are not mitigative as it asserts.[40] They materially increase, rather than decrease the burden on electricity ratepayers.

59. Having regard to all of this evidence, we submit that Hydro One's 2009 and 2010 Capital and Operating Budgets are not mitigative. There are no recession-related spending constraints in those Budgets and there should be.

(v) <u>Unreasonable Compensation Levels</u>

60. It has become increasingly evident that Hydro One pays too much for employee compensation. In essence, the Company acknowledges this in Argument when its counsel states:

> *"This Company has been quite candid with you from the outset that it shares this Board's concerns about the level of – levels of compensation. It has not ignored the problem and it has done its level best to try and do something about it."* [41]

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[38] Exhibit KX3.5 and Transcript Volume 4, page 16, line 13 to page 20, line 14

[39] The evidence in Tables 3 and 5 of Exhibit E1, Tab 1, Schedule 1 indicates that the load loss risk Hydro One planned in its initial filing to recover from transmission ratepayers is $6M in 2009 and $36M in 2010. As a result of the actions taken since November 2008, Hydro One is attempting to recover from distribution ratepayers the full amount of the additional 2009 load loss risk identified in the November 2008 presentation to its Board of Directors.

[40] Transcript Volume 7, page 22, lines 16 to page 24, line 12

[41] Transcript Volume 7, page 12, lines 9 to 17

and later:

> *"I appreciate the Board's … appreciate and understand the Board's frustration over this compensation issue …"* [42]

61. Intervenors share the Board's frustration over the compensation issue to which counsel for Hydro One refers because increases in compensation costs are a major component of the large OM&A increases Hydro One asks the Board to approve for the purposes of deriving its rates for 2009 and 2010.

62. In explaining its high compensation levels, Hydro One, in effect, asserts that it is powerless to constrain the amounts that it pays because it has no leverage over its unionized employees.[43] The contention is, in effect, "we are doing our best but there's nothing further we can do".

63. The disconcerting feature of Hydro One's position with respect to unreasonably high compensation costs is its contention that the Board is obliged to allow Hydro One to recover excess compensation in its rates because Hydro One is at the mercy of its unionized employees. The argument is, in effect, that unreasonably high compensation levels must be recoverable in rates because Hydro One can do nothing to prevent them.[44]

64. This contention, we submit, is substantively the same submission made by counsel for the Society of Energy Professionals (the "Society") in the EB-2006-0501 proceeding. There, counsel for the Society contended that findings by the Board with respect to compensation costs provided pursuant to agreements

[42] Transcript Volume 7, page 14, lines 23 to 26
[43] Transcript Volume 7, page 12, line 18 to page 15, line 8
[44] At Transcript Volume 4, page 169, counsel for Hydro One acknowledged that the Board "has the authority to set the Revenue Requirement regardless of the contractual obligations of the Company."

negotiated as part of the Collective Bargaining process are beyond the jurisdiction of the Board.

65. In rejecting that submission, the Board stated as follows:

> *"The Board's obligation to arrive at just and reasonable rates to protect the interests of the consumers requires it to assess the reasonableness of all costs for which recovery is sought. The Board has a wide discretion to allow, disallow or adjust the components of both Rate Base and Expense."* [45]

and further:

> *"The Board did not and does not prohibit the utility from paying to its work force whatever it negotiates within the context of its labour relations environment. What the Board does do is limit the recovery as part of the revenue requirement to that portion of the compensation costs which the Board finds to be reasonable."* (emphasis added) [46]

66. Now that we are in the midst of a severe recession, the time has come for the Board to limit the compensation costs Hydro One recovers from its ratepayers to the amount which the Board finds to be reasonable. Material increases in compensation costs in the midst of a recession are unreasonable. In recessionary times, net staff additions of 191[47] over the period 2009 and 2010, which increase the OM&A costs of the Company as a whole by some $30M, are questionable.

67. In this case, the Board should find that ratepayers are no longer obliged to pay Hydro One's unreasonably high compensation costs, and that finding should be reflected as part of a global reduction to OM&A expenses in an amount which the Board considers to be appropriate. Our rationale for urging the Board to conclude that a global reduction in OM&A expenses is the appropriate manner of

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45 EB-2006-0501 Decision with Reasons at page 16
46 EB-2006-0501 Decision with Reasons at page 17
47 Exhibit I, Tab 1, Schedule 19; Exhibit I, Tab 1, Schedule 44; Transcript Volume 3, page 150, line 8 to page 155, line 23

proceeding in this particular case and the factors which we suggest the Board should consider in quantifying the amount of that global reduction are discussed in the next section of this Argument entitled "Measuring Unreasonableness in Hydro One's 2009 and 2010 Budgets ".

68. As well, directives should issue again in this case to assure that there is sufficient benchmark information of reasonable reliability in the next proceeding to facilitate better comparisons of Hydro One's compensation costs to those of reasonably comparable business entities.

(vi) Large Increases in Spending Plan Amounts are Unjustified

69. Hydro One seeks to dissuade the Board from making any reductions to its 2009 and 2010 Spending Plans by asserting that it is merely acting in accordance with Government policy as the conduit for Ontario Power Authority ("OPA") projects. The Company also refers to the Government's proposed *Green Energy Act* to dissuade careful scrutiny of its spending plans.. In this case, as in the last, Hydro One also continues to rely on asset aging as justification for some of the significant increases in its 2009 and 2010 Spending Plans.

70. We submit that Hydro One's role as the conduit for OPA projects does not relieve it from its obligation as a public utility to behave prudently. The Board, in exercising its statutory mandate to set just and reasonable rates, should not approve expenditures planned by Hydro One which have not been evaluated for feasibility or reasonableness. Hydro One should not simply assume that project cost estimates provided by third parties are prudent and reasonable. At the very least, it should either conduct or check the results of a feasibility and/or cost

benefit analysis. Hydro One's role, as the conduit for OPA projects, should not prompt the Board to turn a blind eye to matters pertaining to the economic feasibility, reasonableness and/or prudence of the planned expenditures. In the prevailing recessionary circumstances, the Board should be more, rather than less, vigilant with respect to all of Hydro One's spending plans, including those related to its role as the conduit for OPA projects.[48]

71. Similarly, the absence of mitigative measures and recession-related constraints in Hydro One's 2009 and 2010 spending plans cannot be justified by reference to the Government's proposed *Green Energy Act*. The cost consequences for Hydro One and its ratepayers of yet to be passed legislation are not matters in issue in this case.[49] They may become matters for scrutiny in future Hydro One proceedings.

72. We support the submissions of both AMPCO and Energy Probe to the effect that Hydro One's aging assets rationale does not justify significantly increased capital and operating expenditures over historic norms.[50]

73. Hydro One does not purport to justify its large increases in spending on grounds that it is acting to facilitate low cost generation facilities now versus a delay which could result in higher cost options.

74. In all of these circumstances, we submit that the increases in Hydro One's Capital and OM&A Spending Plans for 2009 and 2010 compared to historic

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[48] We expect counsel for CCC to elaborate on this point in his submission.

[49] Transcript Volume 4, page 161, line 8 to page 162, line 20

[50] AMPCO's submissions to this effect are found at page 26 of its Written Argument where AMPCO recommends that the Board constrain Hydro One's sustainment budgets, both OM&A and Capital, to the average of the historical and bridge years. Energy Probe's submissions, which we support, pertain to OM&A spending and are found in paras. 8 to 19 of its Written Argument.

norms, and the absence of recession-related constraints in the spending plans, are not justified by Hydro One's role as the conduit for OPA projects, nor the proposed *Green Energy Act*, nor the age of its assets.

D. Measuring Unreasonableness in Hydro One's 2009 and 2010 Budgets

(i) Onus

75. An applicant seeking Board approval for spending increases which substantially exceed historic norms has a heavy onus to discharge. The Board's 2006 EGD Rates Decision indicates that the onus is on the applicant to convince the Board that "its environment has changed so markedly as to justify the proposed level of … spending."[51]

76. For reasons which follow in this Argument, we submit that Hydro One's evidence fails to discharge this onus and that the Board should direct Hydro One to use materially reduced capital and OM&A Budgets when deriving its 2009 and 2010 Rates.

(ii) No Micro-Management

77. The Board is empowered to make findings of unreasonableness on the basis of factors similar to those which Senior Management and the Board of Directors of Hydro One consider when they review the Business Plan and related Budgets. These factors include compatibility with historic norms and economic indicators, as well as rate impacts and considerations of affordability. Senior Management and the Board of Directors of Hydro One do not express their concerns with

[51] EB-2005-0001 Decision with Reasons, February 9, 2006, at para. 2.2.6

planned spending on a line-by-line basis. Rather, they consider the foregoing criteria in a global context and then exercise judgment accordingly.[52]

78. We submit that the Board's obligation is to tell Hydro One why reduced spending plans should be used in the derivation of its 2009 and 2010 rates. The Board does not need to and should refrain from suggesting to Hydro one the particular categories of spending that should be reduced as the test period progresses as counsel for Hydro One suggest. Telling Hydro One how to respond would be micro-management. Hydro One acknowledges and the Board has stated in prior cases that it is not the Board's role in a Rate Case to micro-manage utility spending plans for any given year.[53]

79. Accordingly, in considering the extent to which Hydro One's spending plans should be reduced to bring them within reasonable limits, the Board should consider both the line-by-line and global amounts of the incompatibility of the budgeted amounts with historic norms, be they bridge year actuals, bridge year Board approved, or multi-year averages. As well, reliable benchmark information pertaining to reasonably comparable business entities should be considered. However, to avoid micro-management, the Board should quantify, on a global or envelope basis, the reduced amount of Hydro One's spending plans to be used in its derivation of rates leaving it to Hydro One to determine how best to manage the spending constraints. There are, as Mr. Aiken has noted in his submissions

52 Transcript Volume 2, page 241, line 4 to page 244, line 10
53 EB-2005-0001 Decision with Reasons, February 9, 2006, para. 2.2.1 where the Board stated "It's not the Board's role in a rates case to micro-manage Enbridge's capital spending plans for any given year."

on behalf of BOMA and LPMA, many areas where spending reductions can be achieved by Hydro One.[54]

(iii) Measures of Capital Expenditure Unreasonableness

80. While consideration of a number of factors can give rise to a finding that the total level of budgeted capital expenditures in a particular test period is unreasonable, the measurement of the extent to which the budget amounts are unreasonable will usually be based on a comparison to historic norms, benchmarking data from reasonably comparable business entities and/or other numeric information such as the "minimum levels" which Hydro One uses in planning its capital and operating expenses.[55]

81. In this case, historic norm information, including actual bridge year total capital expenditures, the average of historical and bridge year actual expenses, and the multi-year average of actual capital expenses demonstrate that the capital budgets for 2009 and 2010 unreasonably exceed the historic norms.

82. The capital spending plans for 2009 and 2010 of $944M and $1,074M total $2,018M or, on average, about $1,009M per annum. The average capital under-spending of $110M per annum for 2007 and 2008, is a very strong indicator of the extent to which Hydro One's 2009 and 2010 capital budgets are too high, as well as a strong indicator of the extent to which Hydro One can constrain capital spending.

[54] BOMA and LPMA Written Argument, pages 12 and 13
[55] Exhibit J2.7

83. Comparison to other historic norm measures such as the five (5) year average capital expenditures plus 20% amount of $588M, the 2008 actual capital expenditures of $704M, and the 2008 Board approved capital expenditures of $774M, support a conclusion that the capital budget amounts for 2009 and 2010 vary from historic norms in amounts substantially greater than the average capital under-spending amount in the past two (2) years of about $110M.

84. We submit that the 2009 and 2010 capital budgets are too high by an amount which is, at a minimum, representative of the actual amount of capital under-spending over the past two (2) years.

85. Expressing this measure of unreasonableness of $110M as a percentage of average total capital spending plan for 2009 and 2010 of $1,009M produces a percentage slightly in excess of 10%.

86. We accordingly support and adopt Mr. Aiken's submissions on behalf of BOMA and LPMA to reduce Hydro One's 2009 and 2010 capital budgets by 10% in each year, and as a consequence to reduce Hydro One's Rates Revenue Requirement in 2009 by $5M and in 2010 by $10M.[56]

87. Having regard to all of this evidence and the line item discrepancies between planned capital expenditures and historic norms, which others have analyzed in their submissions, we urge the Board to direct Hydro One to reduce its capital spending plans in 2009 and 2010 by 10% in order to bring them within the limits of reasonableness.

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[56] Argument of BOMA and LPMA, pages 4 to 6, and Exhibit I, Tab 2, Schedule 18

88. A 10% reduction in the 2009 capital budget of $944M reduces it to about $850M, which is an amount about $146M more than what Hydro One was able to spend in 2008. A 90% reduction in Hydro One's 2010 capital budget of $1,074M reduces it to about $967M, which is an amount about $263M more than what Hydro One was able to spend in 2008. There is, we submit, a very real probability that even at these reduced levels of capital budget spending, there is a very high probability of capital under-spending in 2009 and 2010.

89. In these circumstances, an asymmetric capital under-spending variance account may be justified.[57] The account should be asymmetric and only deal with under-spending because ratepayers have already borne two (2) years of the rate increase burden associated with Hydro One under-spending in 2007 and 2008.

(iv) Measures of OM&A Expenditure Unreasonableness

90. As with capital expenditures, the measures used to quantify OM&A expenditure unreasonableness include historic norm analyses, benchmarks, economic indicators such as inflation, and the "minimum levels" utilized by Hydro One in its business planning and budgeting.

91. Mr. Aiken, in his submissions on behalf of BOMA and LPMA, thoroughly analyzes many of these factors and we adopt and support his analysis.[58]

92. We have previously noted that Hydro One's actual 2008 OM&A expenditures of $373.8M were some $35M below actual 2007 OM&A expenses of $412.9M. We agree with Mr. Aiken that Hydro One's 2009 requested increase of $61.4M in

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[57] Board Staff suggests the establishment of an independent variance account at page 23 of their Written Argument
[58] BOMA and LPMA Written Argument at pages 7 to 11

OM&A expenses from $373.5M to almost $435M is, on its face, "astounding".[59] Even after adjusting the requested increase for the 2008 insurance settlement of about $8.7M, the requested OM&A expenses increase for 2009 of about $435M is an increase of some $52.7M from adjusted actual 2008 expenses of $382.5M.[60] We submit that the requested increase is clearly excessive and note as well that the increases Hydro One asks the Board to approve for 2009 and 2010 exceed the "minimum levels" which Hydro One measures for OM&A expenses planning purposes by $57.7M for 2009 and $52.9M for 2010.[61]

93. We submit that these facts are strong indicators that Hydro One's 2009 and 2010 OM&A spending plans are unreasonably incompatible with actual spending norms and, in particular, the most recent 2008 spending norm of $382.5M when the one time insurance credit amount of $8.7M is taken into account.

94. Factors contributing to Hydro One's unreasonably high OM&A expenses budgets for 2009 and 2010 include compensation which is too high and some $13M in excess of benchmark,[62] the decision to add 192 people to its workforce over the course of the next two (2) years at a cost of some $30M,[63] the lack of productivity, which both Mr. Aiken and Energy Probe address in their Arguments, the absence of any justification for the increase in sustaining OM&A expenses, which both Energy Probe and AMPCO discuss in their submissions, and the property taxes issue, which Mr. Aiken discusses in his Argument.

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[59] BOMA and LPMA Written Argument at page 7

[60] Exhibit K2.4

[61] Exhibit J2.7

[62] Exhibit A, Tab 16, Schedule 2, page 2

[63] Exhibit I, Tab 1, Schedule 19; Exhibit I, Tab 1, Schedule 44; Transcript Volume 3, page 146, line 11 to page 15, line 23

95. In his submission, Mr. Aiken suggests that three (3) approaches be considered for measuring the extent to which Hydro One's 2009 and 2010 OM&A expenses are unreasonable. Each of his suggested approaches provide persuasive support for the conclusion that Hydro One's 2090 and 2010 OM&A Budgets are far too high.[64] The reasonableness of the results of Mr. Aiken's three (3) approaches is corroborated by Hydro One's estimates of the "minimum level" of OM&A expenses it requires in 2009 and 2010 of $377.5M and $396.8M respectively. These amounts are some $57.7M and $52.9M below the amounts of about $435M and about $450M that Hydro One asks the Board to approve for 2009 and 2010.[65]

96. Of the three (3) approaches Mr. Aiken discusses, the one we find to be most appealing is his application of the OM&A expenses growth rates in the original Application to the actual 2008 bridge year OM&A costs. Mr. Aiken applies these OM&A expenses growth rates of 8.1% for 2009 over 2008, and 3.3% for 2010 over 2009 to the actual OM&A expenses of $373.5M to produce OM&A expense allowances for 2009 of $404.1M and for 2010 of $417.4M, which represent a decrease of $31.1M and $32.2M for 2009 and 2010 respectively.[66]

97. We note that if these growth rates are applied to the 2008 OM&A expenses of $382.5M to reflect the adjustment for the one-time insurance settlement received in that year, the OM&A expenses levels for 2009 and 2010 would become $413.5M and about $427.1M respectively. These amounts represent a decrease

[64] BOMA and LPMA Written Argument pages 8 to 11
[65] Exhibit J2.7
[66] BOMA and LPMA Written Argument at page 8

in OM&A expenses from the levels proposed by Hydro One of $435M for 2009 and $450M for 2010 of $21.5M for 2009 and about $23.9M for 2010.

98. Subject to our suggestion that the 2008 one-time insurance settlement should probably be taken into account when Mr. Aiken's growth rate from forecast approach is applied, we agree with Mr. Aiken that his three (3) approaches provide the range into which a reasonable OM&A expenses allowance for Hydro One falls.

99. We recommend that Mr. Aiken's growth rate approach be applied to adjusted 2008 actual expenses of $382.5M to produce OM&A expenses for 2009 and 2010 of $413.5M and $427.1M respectively. These amounts, we submit, represent the upper limit of the OM&A expenses amounts which the Board should approve for Hydro One and that Hydro One's 2009 and 2010 OM&A expenses budgets should be reduced in each year by an amount of between $21.5M and $23.9M.

E. Under-Estimates of Revenues

(i) <u>External Revenues</u>

100. We adopt and support Mr. Aiken's submissions to the effect that Hydro One's 2009 and 2010 forecasts for External Revenues are too low.[67]

101. We also submit that the Land Use Rental revenues in both 2009 and 2010 should be included in the Budgets at the average level recorded in 2005 through 2008, which is an amount of $16.4M according to Mr. Aiken. Hydro One's

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67 BOMA and LPMA Written Argument at pages 17 to 19

forecast of the Secondary Land Use revenues at just over $11M is incompatible with historic norms and should be rejected.

102. We also support Mr. Aiken's suggestion that a variance account be established to protect Hydro One and ratepayers but with the amount embedded in rates to be $16.4M and not Hydro One's lower forecast of about $11M.

103. We also support Mr. Aiken's analysis of Station Maintenance and Engineering and Construction Net Revenues and his submission that Hydro One's forecast of these net revenues is too low and should be increased by $600,000 in 2009 and by $700,000 in 2010.[68]

(ii) <u>Export Revenues</u>

104. Mr. Aiken deals with the unreasonableness of Hydro One's forecast of Export Revenues in his submissions. We support his submissions and will not repeat them.[69]

105. We also agree with and support Mr. Aiken's rationale for establishing a variance account with respect to these revenues and that the amount to be embedded in rates is not the $12M forecast proposed by Hydro One but an amount of $24M representing actual Export Revenues realized in 2008. Hydro One's $12M forecast for Export Revenues in each of the years 2009 and 2010 is incompatible with the historic norm.

106. Our understanding is that Hydro One agrees that a variance account should be established for Export Revenues.[70]

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[68] BOMA and LPMA Written Argument at page 18
[69] BOMA and LPMA Written Argument at page 16
[70] Transcript Volume 5, page 104, lines 11 to 23

F. Deferral Accounts

(i) Clearance of Credit Balances in Deferral Accounts

107. Mr. Aiken has discussed this matter in his submissions and we agree with him that the credit balances in the deferral accounts should be cleared over the course of the eighteen (18) month test period, rather than over four (4) years as Hydro One proposes. [71]

108. We understand the evidence to indicate the effect of clearing these credit balances over eighteen (18) months rather than four (4) years is to further reduce the Rates Revenue Requirement by $1.4M in 2009 and $7.8M in 2010.[72]

(ii) Proposed IPSP Pre-Engineering Expenses Deferral Account

109. In its submissions, AMPCO lists a number of reasons why Hydro One's proposal to record IPSP Pre-Engineering Expenses in a deferral account for disposition at a later date should be rejected.[73]

110. We support and adopt AMPCO's submissions and emphasize that these expenditures are essentially capital expenditures in the making. We submit that they should not be regarded, for regulatory purposes, as OM&A expenses as Hydro One suggests.

(iii) Proposed Recognition of Capital Expenditures on Projects not Forecast to be in Service in the Test Period

111. We submit that there should be no special treatment for these types of expenditures.

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71 BOMA and LPMA Written Argument at pages 19 and 20; Exhibit J3.4 and note
72 Exhibit J3.4 compared to Hydro One's initial filings
73 AMPCO Written Argument at pages 28 to 30

G. Placeholders and Other Costs of Capital Issues

112. We urge the Board to use the currently approved amounts for Rate of Return on Equity ("ROE") of 8.01%, for Long Term Debt of 7.62%, and Short-Term Debt of 1.33% when estimating the Rates Revenue Requirement impact of its Decision in this case.[74]

113. We also note that, during the course of the hearing, Hydro One agreed to the income tax rates in force when the Decision is rendered for the purposes of estimating the Payment-in-Lieu of taxes ("PILs") component of its rates.[75]

114. We adopt and support without any further elaboration the submissions of Mr. Aiken to the effect that Hydro One's costs associated with Long Term Debt should be reduced by $2.3M in 2009 ($1.3M for 2008 actual debt issuance, $0.6M for deemed debt, and $0.4M for treasury costs), and $1.7M in 2010 ($1.3M for 2008 actual debt issuance, $0.4M for treasury costs).[76] We also agree with Mr. Aiken that Apprenticeship and Scientific Research and Experimental Development tax credits should be included in Hydro One's calculation of regulatory taxable income in amounts which are compatible with historic norms.[77]

115. We also support Mr. Aiken's submission that Hydro One's taxable income should be reduced in 2009 and 2010 to reflect the availability of the increase CCA deduction for computers.[78]

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74 Exhibit J3.1
75 Transcript Volume 5, page 39, line 20 to page 40, line 22
76 BOMA and LPMA Written Argument pages 23 to 28
77 BOMA and LPMA Written Argument pages 14 and 15
78 BOMA and LPMA Written Argument pages 15 and 16

H. Summary of CME's Suggested Revenue Requirement Adjustments

116. In the Table below, we summarize the estimated effects of the adjustments we submit should be made to the 'as filed' Rates Revenue Requirement increase amounts of $62M for 2009 and $110M for 2010.

As Filed	**($M)**	**2009 ($M)**	**($M)**	**2010 ($M)**
Rates Revenue Requirement Increase		62		110
Adjustments:				
• 10% reduction in Capital Budget	5.0		10.0	
• Updates of Cost of Capital (Exh J3.1)	22.9		58.8	
• Cost of Debt changes per Mr. Aiken's submissions	2.3		1.7	
• Taxes per Mr. Aiken's submissions	0.3		0.1	
• Incremental Export Revenues	12.0		12.0	
• External Revenues ▫ Station maintenance engineering and construction incremental margin	0.6		0.7	
▫ Secondary Land Use revenues	16.4		16.4	
• OM&A Expenses	21.5		23.9	
• 18 month Clearance of Deferral Account Credits	1.4		7.8	
	82.4		131.4	
Adjusted Rates Revenue Requirement (Decrease)		(20.4)		(21.4)

117. The adjustments summarized in this Table indicate that Hydro One's 2009 and 2010 Rates should be derived from Board approved budgets which produce Rates Revenue Requirement decreases for 2009 and 2010, rather than the increases Hydro One asks the Board to approve.

I. AMPCO's Proposal

118. AMPCO proposes to change the way transmission network demand is measured for billing purposes. It targets the highest peak loads that stress the transmission

system. The demand measurement method AMPCO proposes is in use in other jurisdictions so that the methodology is not something that is without precedent. If approved, the AMPCO proposed method for determining billing demand will provide industrial end-use transmission customers with a greater incentive to shift their demands off coincident system peaks.

119. If the proposal is implemented, then it will shift costs from industrial end-use transmission customers to LDCs. The LDCs will, in turn, pass these increased transmission costs on to their customers. CME members are customers of LDCs. Accordingly, the transmission cost shifts associated with AMPCO's proposal will lead to some increased transmission costs being absorbed by CME members.

120. The AMPCO evidence, including the expert evidence from Dr. Sen, demonstrated that the incremental peak shaving actions by industrial end-use transmission customers, which is likely to ensue if AMPCO's proposal is implemented, will lead to lower electricity prices for electricity customers as a whole. These lower electricity prices will be realized because the system coincident peaks will be less constrained as a result of the peak shaving actions taken by end-use transmission customers.

121. AMPCO's evidence was to the effect that the lower commodity costs attributable to the peak shaving activities, which the proposal will prompt, will exceed the transmission costs shifted from end-use transmission customers to the remaining customers on the system by a ratio of about 7 to 1. The AMPCO witnesses expressed confidence in his estimates, giving rise to this favourable benefit cost

ratio and indicated that the achievement of net benefits by those burdened with the costs of the proposed methodology could be objectively demonstrated following its implementation.[79]

122. As a matter of principle, CME supports the implementation of a methodology which produces net benefits for those burdened with its costs. If those who pay the costs of implementing a new methodology realize a net benefit, then it makes sense to approve and implement and proposal. The situation is otherwise when there is no positive net benefit for those burdened with the costs.

123. The implication of the submissions of counsel for Hydro One are to the effect that there may be adverse impacts associated with AMPCO's proposal which operate to either reduce or eliminate its net benefits for those burdened with the costs of its implementation.[80] Even if the benefit cost ratio is not 7 to 1 as AMPCO's witnesses indicated and instead is as low as 3 to 1, or even 2 to 1, it still makes sense to implement the methodology if the Board is satisfied that those burdened with its costs will benefit from electricity commodity cost savings in excess of those costs.

124. In order to allow Hydro One an opportunity to produce evidence to the effect that there are adverse impacts associated with AMPCO's proposal which operate to reduce or eliminate the net benefits of its implementation on those burdened with its costs, we suggest that the Board consider approving the proposal with a direction for its implementation by a deadline date, such as January 1, 2011,

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79 Transcript Volume 6, page 111, line 9 to page 115, line 14
80 Transcript Volume 7, page 19, line 1 to page 22, line 15

subject to Hydro One's right to produce evidence before December 31, 2009, showing that there are adverse impacts associated with the proposal which materially reduce or eliminate its net benefits for those burdened with its costs. If Hydro One produces such evidence by December 31, 2009, then these alleged adverse impacts can be scrutinized in its next Rate Case.

125. As well, implementation of the proposal should be accompanied by measures designed to assure that the net benefits to those burdened with its costs are demonstrable. In this context, we suggest that directions with respect to the implementation of the proposal also include a requirement that Hydro One collaborate with AMPCO and other stakeholders to establish a monitoring and reporting mechanism which can be used to demonstrate the extent to which lower electricity prices are being realized because coincident peaks are less constrained as a result of the peak shaving actions taken by end-use transmission customers.

J. Costs

126. CME respectfully requests that it be awarded 100% of its reasonably incurred costs of participating in these proceedings.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 23rd day of March, 2009.

Peter C.P. Thompson, Q.C.
Vincent J. DeRose
Counsel for CME

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