EB-2008-0272

ONTARIO ENERGY BOARD

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

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

FINAL ARGUMENT

ON BEHALF OF THE

SCHOOL ENERGY COALITION

March 19, 2009

SHIBLEY RIGHTON LLP
250 University Avenue, Suite 700
Toronto, Ontario M5H 3E5

John De Vellis
Counsel to the School Energy Coalition

INTRODUCTION

1. These are the Final submissions of the School Energy Coalition ("SEC") in the application by Hydro One Networks Inc. ("HON") seeking changes to the uniform provincial transmission rates.

2. The focus of SEC's submissions will be on HON's spending plans, particularly in the areas of OM&A.

3. In this application HON seeks an increase to its rates revenue requirement in the amount of 15% over two years [E1-1-1]. That increase, however, does not tell the whole story, as HON's OM&A and capital program are increasing at even faster rates. When all of the planned capital programs come into service the total impact on ratepayers from HON's current spending plans will be even higher than 15%.

4. As will be set out in greater detail below, the focus of SEC's submissions will be on the level of HON's work program and the cost of it. While it is clear some ramp up of spending is required to achieve the government policy of shifting from a nodal generation to a distributed generation focus in the Ontario electricity grid, in SEC's submission that priority cannot justify the substantial spending increases HON has exhibited in other areas.

5. In SEC's submission, the pace of HON's spending since 2003 is unsustainable. At a time when residential ratepayers and businesses are facing stagnant or falling wages or business revenues, ever increasing electricity costs will add to this province's economic hardship. In SEC's submission, the damage to Ontario's economic competitiveness caused by the increasing

energy cost burden is antithetical to the government's goal of fostering a green economy as a means of lifting us out of the current economic crisis.

Issue 1.1. Has Hydro One responded appropriately to all relevant Board directions from previous proceedings?

6. See Issue 3.3 below.

Issue 2.2: Are Other Revenue (including export revenue) forecasts appropriate?

7. As noted in Board Staff's submissions, HON's forecasted export revenues for 2009 and 2010 ($12 million) are well below the 2006-2008 average. The justification for the $12 million figure is a reference in the pre-filed evidence to IESO's business plan. That business plan, however, shows that IESO's projected 2007 and budgeted 2008 figures were $11.2 and 10.9 million, respectively. That is well below HON's actual export revenues of $14.1 and $24.6 million for the same years [Undertaking J.2]. It does not appear, therefore, that the IESO business plan is a reliable predictor of HON's export revenues.

8. SEC believes, therefore, that the export revenues are under-stated. SEC believes a reasonable approximation for 2009 and 2010 revenue would be the average of the prior three years, or $17.3 million.

OM&A

Issue 3.1 Are the proposed spending levels for Sustaining and Development OM&A in 2009 and 2010 appropriate, including consideration of factors such as of system reliability and asset condition?

9. In a recent rate proceeding involving Toronto Hydro, the Board said that "except in compelling circumstances, Utility spending should be managed so as to be reasonably level, with highs and lows lying within a fairly narrow range of change. To the extent possible, ratepayers should not be exposed to volatile changes in their delivery rates." [EB-2007-0680, p. 37.]

10. In the current proceeding, HON's Sustaining, Development and Operations OM&A is forecast to increase by almost 20% in 2009 over 2008, from $244.3 million to $292.8 million. A further six percent increase is forecast in 2010, bringing the total increase in the test years of $66 million, or 27%.

11. As staggering as the increases in the test years are, they come on heels of several years of spending increases that were well above the rate of inflation. The following graph charts HON's Sustaining, Development, and Operations ("SDO") OM&A from 2003 to 2010:

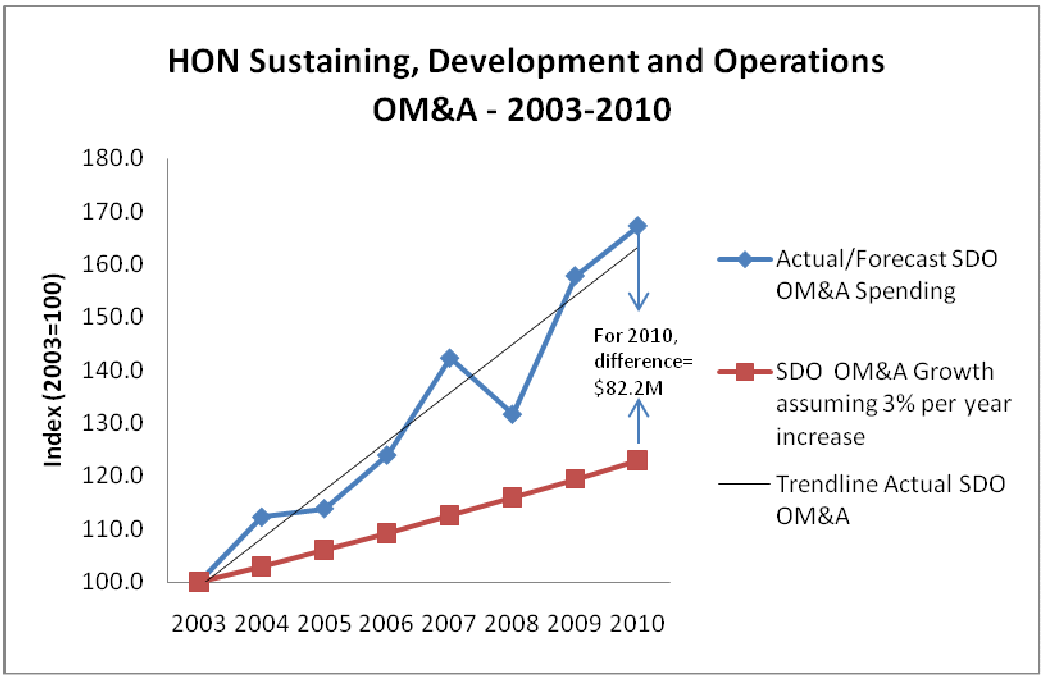

Figure 1: data derived from Exhibit K2.1 and Exhibit C2/2/1.[1]

12. In order to provide a comparison to see what HON's actual/forecast spending would be when compared to a baseline amount, we have shown on the graph what HON's spending would look like if it increased at a rate of 3% per year from 2003. Assuming 2% inflation [see Exhibit A, Tab 14, Schedule 2, p. 3] and 0.8% productivity each year [Ex. A-16-1, p. 6], the 3% figure represents, in SEC's submission, a real increase in work accomplishment of 1.8% per year.

13. As is indicated on the graph, by 2010 the difference between HON's projected spending and the spending that would have resulted from the 3% annual increase amounts to over $82 million [$310.3 million versus $228.1 million- see Exhibit K2.1].

[1] The data used to complete this graph as well as Figure 2 is included as Appendix A to these submissions.

14. SEC is not suggesting that HON's OM&A should have increased by 3% per year. Nonetheless, the comparison to that baseline figure demonstrates the extent to which HON's past and planned spending has or will exceed reasonable year over year increases. What's more, the trend line in the above graph shows that the gap will continue to grow in coming years. In SEC's submission, the pace of HON's OM&A spending is unsustainable.

15. Increased spending of this magnitude may be explained by the fact that the system is growing and that therefore the levels of expenditures, on a per unit basis, are not growing as fast. However, HON's benchmark figures show that that is not the case. The spending increases have translated into significant increases in per unit costs and consequently to the amounts paid by ratepayers.

	2003	**2008**	**2009**	**2010**		
Total SDO OM&A ($ millions)	185.5	244.3	292.8	310.1		
Total Transmission Lines (circuit-km)*	28,621	28,601	28,682	28,767		
Units Transmitted (TWH)*	151.7	148.7	149	145.1		
					% Change	
					2010 vs. 2003	**2010 vs. 2008**
SDO OM&A per line KM ($/line KM)	6,481	8,541	10,208	10,779	**66.3**	**26.0**
SDO OM&A per unit ($/TWH)	1,222,808	1,64,2,905	1,965,101	2,137,147	**74.8**	**30.0**

***Source**: Exhibit K2.2; Exhibit A/11/1/Att 1: Hydro One Inc. 2007 Annual Report, pg 82. 2008 to 2010 data is from Undertaking J2.2.

16. As can be seen from the above table, by 2010 SDO OM&A per line KM and per unit transmitted will have increased 66.3% and 74.8% respectively over 2003. Between 2008 and 2010 alone these figures increase by 26% and 30% respectively.

17. These figures mirror the change in HON's compensation metrics. In Undertaking J4.3, HON was asked to update the results, for HON, from the Mercer-Wyman compensation and benchmarking study (more on the Mercer study in section 3.3 below). The response shows that all of the compensation benchmarks examined by Mercer are increasing significantly over the test years:

Compensation Metrics for Transmission and Distribution		**2009 Forecast**	**2006 Exhibit A-16-2 Attachment 1**	**% Change-2006-2009**
Compensation per MWh	$/MWh	2.75	2.14	29%
Compensation per Asset	$/$1000 asset	32	31	3.2%
Compensation per Line KM	$/KM	4080	3599	13.4%
Compensation Per Service Territory	$/Sq. KM	807	670	20%
Compensation Metrics for Customer Service 2009		**2009 Forecast**	**2006 Exhibit A-16-2 Attachment 1**	**% Change-2006-2009**
Compensation per MWh	$/MWh	0.32	0.21	52%
Compensation per Asset	$/$1000 asset	3.72	3.05	22%
Compensation per Line KM	$/KM	472	351	35%
Compensation Per Service Territory	$/Sq. KM	93	65	43%

Source: Exhibit J4.3

18. What is also evident from Figure 1 above is that, despite the fact that SDO OM&A actually decreased in 2008 (to $244 million from $264 million in 2007) HON is sticking with its 2009 forecast of $300.8 million. The result is that the 2009 forecast is $55 million greater, or 23%, higher than 2008. [Exhibit K2.1]

19. The Company's response to this line of criticism of its planned spending is that the program spending has been fully justified: "detailed reasons and explanations have been given in

the evidence to show why this level of expense is prudent and why it is required." [HON Argument in Chief, Transcript V. 7, p. 11]

20. SEC's response is three fold: first, the increase in the test years, as large as they are, come on top of several years of spending increases that were well above the rate of inflation. The result is a rate of growth in expenditures that is unsustainable.

21. Second, with respect to the increases in the test years in particular, ratepayers have a right to expect that a regulated utility will be run without massive increases in spending in a short period of time. In SEC's submission a business run on commercial principles should seek to keep overall cost increases to a reasonable rate of growth.

22. Finally, SEC does not believe that HON's evidence justifies the large increase in spending it is seeking. As is discussed in greater detail below, SEC believes that the explanations provided in many cases simply describe the increased work program. They do not explain the sudden need for large increases in planned work accomplishments.

23. Any business can justify individual work plans as being necessary or desirable. Most companies have internal proposals, with legitimate supporting analysis, totaling significantly more than they can budget or even achieve in a given year. The difference is that businesses in competitive markets also have to justify the overall size of their budget, and prioritize spending to stay within that reasonable level. "Good" work programs have to be cut, because spending above a reasonable level is not sustainable.

24. We now turn to some specific areas of HON's OM&A budget in order to challenge HON's assertion that the level of increase has been fully substantiated in the evidence.

25. The areas that are increasing the fastest are:

	2008	2009	2010	Increase: 2008-2010	
Sustaining OM&A				$	%
Stations					
Power Equipment	57.9	74.7	82	24.1	42%
Ancillary System Maintenance	12.1	18.2	21.0	8.9	73%
Protection, Control, Monitoring Metering and Telecommunication	36.4	39.5	41.6	5.2	14.3%
Development OM&A					
Research and Development	2.7	6.0	9.2	6.5	240%
Operations OM&A					
Operators	29.1	33.1	34	4.9	17%
Total				**49.6**	
Total SDO OM&A	244.3	292.8	310.1	**65.8**	**27%**

26. The above line items represent over 75% of the total increase in Sustaining, Development and Operations OM&A (49.6/65.8) and almost two thirds of the total increase in OM&A (49.6/75.9) between 2008 and 2010.

Power Equipment

27. With respect to Power Equipment, HON's evidence is that the increased expenditures are due to the fact that an increasing number of power equipment assets are entering their mid-life and end of life regions. [Ex. C1-2-2, p. 14]

28. When asked what new work would be accomplished with the additional $24.1 million in OM&A spending on Power Equipment, HON stated that it would be increasing preventative maintenance by 34%, holding the line on corrective maintenance and increasing transformer refurbishments by 49% [I-4-10, p. 2]

29. Those kinds of increases would suggest that the age profile of the assets was increasing rapidly during the test years. In fact, the evidence shows only a slight increase in the number of transformers and circuit breakers entering the end of life region during the test years. The number of circuit breakers that will be in the end of life region in 2010 is 8% higher than in 2008. For power transformers, the figure is 12.5% [see Ex. D1-3-2, p. 11 and 21, respectively; see also Figures 1 and 2 in Ex. C1-2-2, p. 15-16]

30. HON also states, in its Sustainment capital evidence, that the performance of its power transformers is deteriorating [D1-3-2, p. 22]. In response to an interrogatory from SEC, HON provided the relevant performance metrics for the assets. They are shown below[2]:

[22] The definitions for each metric were also provided: "Freq" represents the number of forced outage events experienced per equipment unit per year. "Unavail" represents the extent to which the equipment is not in service and measured as hours per unit per year.

Voltage	Hydro One					
	2005		2006		2007	
	Freq	Unavail	Freq	Unavail	Freq	Unavail
115 kV	0.27	35.8	0.23	36.5	0.30	24.3
230 kV	0.23	23.9	0.20	16.0	0.21	13.0
500 kV	0.82	167.7	0.73	238.5	0.80	86.5

Source: I-4-32, p. 2.

31. As can be seen from the above table, the data do not show a deterioration in performance. Both the frequency and length of outages appear to fluctuate during the period.

32. HON was asked about this apparent inconsistency in cross-examination. The HON witnesses referred to the fact that there have been a number of failures of the 500kV transformers, and that HON's performance relative to CEA national average as an indication of deteriorating performance [Tr2:64]. While there may undoubtedly be trouble spots, the performance metrics do not, in SEC's submission, disclose the need for the kind of increases in this area proposed by HON.

33. Furthermore, the performance indicators included in the package of slides provided by HON, which were part of HON's stakeholder meetings prior to filing this application, also do not show the significant degree of deterioration implied in the pre-filed evidence. These slides show

that HON's circuit breakers and transformers have either a declining or stable number of forced outages since 2003. Only the 500kV transformers show a significant increase in forced outages.[3]

34. In addition, the text from the presentation does not suggest a need for a rapid escalation in work:

> [With respect to Equipment Unavailability generally]:
>
> Overall Equipment Unavailability is another key leading indicator of Delivery Point Performance and *Hydro One has managed to keep it's key equipment available for service more often over the last five years* than during the historical period, despite the aging of the Transmission system.
>
> The overall trend however shows *some* concern.
>
> …
>
> [With respect to 230kV Transformer Equipment Outages]:
>
> Transformers are critical assets which can affect Delivery Point performance, when Forced outages occur. *Hydro One has managed to reduce the number of outages caused by Transformers over the last five years*, relative to the historic period, on which our Delivery Point Performance is based.
>
> …
>
> [With respect to 230kV Breaker Equipment Outages]:
>
> There has been a slight degradation from the historical performance of our 230kV Breakers over the last five years, however *the trend indicates that we have found methods to improve this performance*.[4]

[3] See Exhibit K3.1, Attachment B.

[4] Exhibit K3.1, slides 7, 8 and 9. Emphasis added.

35. Finally, SEC notes that spending for Power Equipment in the test years is $52.7 million ($30 million in 2009 and $22.7 million in 2010) higher than what HON identified as the "minimum" level in response to Undertaking J2.7. HON was asked to provide an explanation for this variance. HON's response, in SEC's submission, was simply a re-statement of the pre-filed evidence: with respect to transformer and breaker refurbishments, for example, HON states that the increase above minimum (total of $32.9 million in the test years for transformer and breakers combined) "is required to address the continued deterioration in transformer [/breaker] performance detailed in Section 3.3 of Exhibit C1, Tab 2, Schedule 2 and in [I-1-30 and I-6-28]" [J4.2] Section 3.3 of Ex. C1-2-2, however, mainly describes the asset demographics which, as noted above, does not justify a 40% increase in the work program.

36. Of the two interrogatory responses referred to in J2.7, exhibit I-1-30 provides a table with only a brief summary of performance issues. In SEC's submission, that table could describe performance issues that exist in any given year and does not, in and of itself, explain the reason for such a large increase in work in the test years. The other exhibit mentioned- I-6-28- simply describes the number of refurbishments that HON intends to carry out in the test years. It does not, as the answer to J4.2 implies, detail performance issues.

Ancillary Systems

37. With respect to Ancillary Systems, HON stated that its work program was to increase the amount of preventative maintenance by 47% and refurbishments by 31% [I-4-11]. HON provided an undertaking response breaking down the work being done [Exhibit J2.3]. Again, the

theme is a ratcheting up of planned maintenance (in some cases doubling the number of maintenance activities by 2010).

38. With respect to corrective maintenance, HON states that the budget has increased from $2.2 million in 2007 to a projected level of $4.6 million by 2010 [see J2.3, p. 1]. That is a doubling in projected level of reactive maintenance expenditures in just three years.

39. With respect to the "minimum" vs. filed levels for this program set out in Exhibit J2.7, we see that HON identified $14.4 million as the "minimum" level for 2009 and has applied for funding in the amount of $18.2 million. However, even the identified "minimum" level is nearly 50% greater than the average spending in this category from 2005 to 2007.[5]

40. Interestingly, the $14.4 million identified as the "minimum" spend level in Exhibit J2.7 is identical to the level of spending that was forecast for 2007 in the 2007 transmission rate application [see Exhibit K2.1] The actual amount spent in that year was $9.6 million. [ibid]

Research and Development

41. Research and Development expenditures more than double from 2007 to 2010. Test year expenditures are $15.5 million above the "minimum" level set out in Exhibit J2.7. Although classified as "minimum" these levels would in fact be approximately equal to the level of expenditures in R&D in the historical period.

[5] Spending Ancillary System Maintenance was: $9.9M in 2005, $9.6M in 2006, and $9.9M in 2007. Spending increased to $12.1 million in 2008 [Exhibit C2-2-2].

42. In addition, although the R&D budget increases in 2010 by an additional $3.2 million over 2009 ($6.5 million over 2008) HON does not yet even have a list of projects for 2010 [I-4-14]. HON is therefore forecasting a level of expenditures in 2010 that is 240% greater than the bridge year even though it does not know where it will spend the money.

43. While there are undoubtedly benefits from R&D spending, SEC submits that the increases sought by HON are unreasonable and that HON has not justified such a large increase in a short period of time.

44. In the following section SEC discusses a key cost component of HON's expenditures, its compensation costs. SEC believes that the above analysis, in conjunction with the discussion below regarding HON's compensation levels, discloses a need for a substantial reduction in HON's OM&A levels for the test years.

3.3 Are the compensation levels proposed for 2009 and 2010 appropriate?

45. The Board has provided direction to HON a number of times with respect to its compensation costs. These directions have come in rate proceedings pertaining to both HON's distribution business and its transmission business.

46. In the 2007 Transmission application, the Board summarized the direction given to the company during the 2006 distribution rate proceeding, as follows:

- In future rate cases it expects Hydro One to identify what steps the company has taken or will take to reduce labour rates;

- The contrast between the compensation structure of Hydro One and some other utilities is of concern; and

- In future rate cases it expects Hydro One to demonstrate that lower compensation costs per employee have been achieved or to have concrete initiatives in place to bring compensation costs more in line with other utilities.

  [EB-2006-0501, p. 29]

47. As seen in the chart below, however, HON's average compensation, particularly for PWU, continues to grow at unacceptable levels:

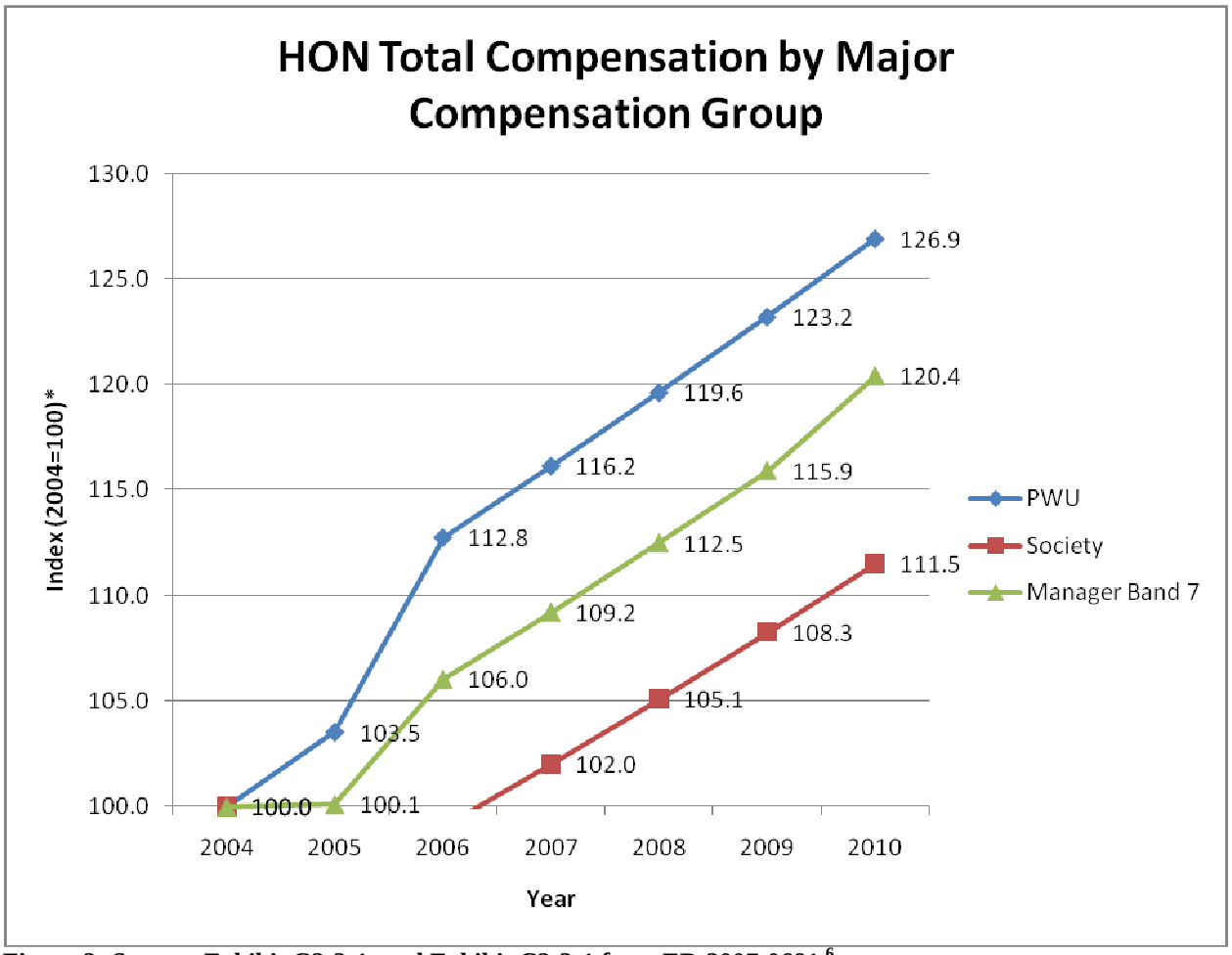

Figure 2: Source- Exhibit C2-3-1, and Exhibit C2-3-1 from EB-2007-0681.[6]

[6] The index for Society is based on 2004 as well (i.e. 2004=100), however line for Society appears truncated due to the impact of the 2005 strike, which caused average total compensation for Society members in 2005 to be significantly below average ($69, 201 in 2005 compared to $96,423 in 2004 and $95,524 in 2006). As a result, it appears as though there are no values for Society for 2005 and 2006 when in fact those values are significantly below 100 in 2005 and slightly below 100 in 2006. All of the values shown for Society, however, are indexed to

48. By 2010, total compensation for PWU will be 27% higher than in 2004. PWU wages are growing at a faster rate than the other compensation groups. This finding is particularly troubling given the results of the Mercer Wyman study, discussed below.

49. In this proceeding, the company presented a compensation and benchmarking study prepared by Mercer and Oliver Wyman [Exhibit A-16-2, Attachment 1] The study confirms that HON's compensation, in particular that related to PWU-affiliated positions, is above the industry average. On a weighted average basis, the difference between PWU wages and comparators is 21%. A number of positions, however, exhibited far greater disparities between comparator groups: total compensation for regional maintainers is 27-29% above the benchmark median; lines supervisors are 43% above the benchmark median. [Mercer-Wyman study, Exhibit A-16-2, Attachment 1, p. 19]

50. In the face of this demonstrated imbalance between its PWU wages and that of its comparators, the company's response in this proceeding is the same as it has always been:

> The common view is that an attempt by Hydro One to achieve significant cost reductions in wages, benefits and pension would likely result in a strike. The last PWU strike was in 1985 and lasted 12 days. It was handled by placing management and Society-represented staff in key functions to maintain operations/service to the extent possible. However, as a result of numerous downsizing programs, and reorganization of work, there are far fewer management staff available today with the requisite skills and experience to occupy key PWU positions during a strike. Furthermore, unlike other industries, Hydro One does not have a product that can be stockpiled. As a result, the Company would be

---

2004 total compensation. For example, the 2007 value (102%) equals 2007average total compensation of $98,390 divides by 2004 value of $96,423 times 100. See Appendix A attached for all data used to construct the line graph.

> unable to continue operations for a sustained period of time during a PWU strike.
>
> Rather than risk jeopardizing the supply of reliable electricity, the key focus with respect to the PWU has been to achieve increased management flexibility to run the operations, as opposed to wide scale reductions in wages, benefits and pensions.
>
> [Pre-filed evidence, Exhibit C1, Tab 3, Schedule 2, pg. 5, lines 12-24]

51. In addition to the Mercer report, there is anecdotal evidence that other utilities feel the level of compensation paid by HON puts upward pressure on their compensation levels.

52. In its submissions in its recent cost of service rate application, Collus Power Corp., responding to submissions regarding its compensation, stated as follows:

> One of the economic realities of the LDC business that 324 COLLUS must carefully consider and make decisions about is that a competitive 325 salary must be paid to the skilled labour force it has or risk losing staff to higher 326 paying positions with a company like HONI. It is evident in the electricity distribution 327 service sector that line personnel are a premium commodity and this will only get 328 worse. HONI pays a premium wage to their line personnel and this places pressure on 329 all LDC's to stay in tune or lose their experienced staff.
>
> [Exhibit K4.2; original document: Submissions of Collus Power Corp. in EB-2008-0226, p. 17]

53. Although the excerpt quoted above merely expresses Collus Power's opinion regarding the impact of HON on its compensation, it is an opinion that is confirmed by the Mercer-Wyman report.

54. Midland Power also echoed the same sentiments when it said in the Reply submissions in its recent cost of service rate application. Responding to criticism that its compensation had increased:

> Midland submits a 3% increase year over year including the labour component is inappropriate and is not a reflection of the reality of Midland's labour compensation …. Midland submits an increase of 3% year over year, excluding the labour component is appropriate. In addition, it is clear to Midland that VECC and SEC do not understand how an LDC conducts its operations and the pressures placed on it to be competitive in the labour market. If we are not competitive, we will lose staff to neighbouring LDC's or other jurisdictions outside Canada. This has happened to Midland and is due to the inequitable wage rates. Consequently, Midland is taking steps to bring wage rates within those of neighbouring LDCs – i.e. market rates.
>
> [EB-2008-0236, Reply Submissions of Midland Power Utility Corporation, p. 20]

55. Although Midland does not mention Hydro One, the only "neighbouring LDC" to Midland is Hydro One Distribution.

56. In SEC's submission, the impact of HON's wages on those of other utilities may indicate that the difference between HON and its comparators may in fact be under-stated.

57. Due to its size, HON is in a position to influence the compensation levels of other similarly situated employers, which means that HON's compensation may be causing other utilities' compensation to be higher than it otherwise would be. This not only affects the comparisons between utilities, but also means that the HON compensation problem is a bigger problem than just HON. It is a problem for the sector as a whole, and thus must be addressed in a more urgent basis.

58. In SEC's submission, at a time of economic turmoil with thousands of people losing their jobs or being asked for wage and benefit concessions in an effort to save their jobs, HON's

reaction that it can do nothing to correct the demonstrated imbalance between its wages and that of its industry comparators is simply inadequate.

59. HON's response, essentially, is that it realizes that its PWU wages are economically unjustifiable, but that its hands are tied because it cannot afford a strike by PWU.

60. As SEC has argued in the past, the Board's job is to act as a proxy for economic pressure that would be created by a competitive market. In SEC's submission, in a competitive market, PWU and HON would have conceded long ago that its wage structure is unsustainable.

61. In response to an undertaking, HON was asked to provide the impact on the overall revenue requirement if HON's compensation was equivalent to the median identified in the Mercer-Wyman report.

62. In response, HON stated that HON's revenue requirement would be reduced by approximately $13 million in each of 2009 and 2010 if its compensation were at the median level [Exhibit J3.5]

63. An examination of the undertaking response, however, reveals that the $13 million revenue requirement impact does not completely demonstrate the extent to which HON's compensation is above the market median.

64. That is because the $13 million figure is derived by taking the total number and multiplying it by the proportion of total Networks compensation costs that are in the Transmission OM&A work program (16% in 2009 and 15% in 2010). The figure assumes that only compensation costs charged to OM&A impact HON's revenue requirement. That is clearly

not the case: HON's revenue requirement includes a significant component of capitalized labour costs.

65. The actual amount by which Networks' compensation is above the market median is $82 million in 2009 and $85 million in 2010. The PWU-represented workforce makes up $64 million ($66 million in 2010) of this total. [Exhibit J3.5, p. 3, column G]

66. In SEC's submission, the latter figures represent the real extent to which Ontario consumers are over-paying for HON's inflated labour costs.[7]

67. These costs represent a drag on Ontario's economic efficiency at a time when consumers and businesses can least afford it.

68. In recent weeks and months we have seen other major industrial unions, whose employers have similarly been reluctant to face a strike, make significant wage and benefit concessions as a result of the economic crisis. In SEC's submission, these concessions were necessitated in part because previously negotiated wage costs were uncompetitive and therefore unsustainable in the long run. SEC believes that, as an economic regulator, this Board has a responsibility to impose "market" discipline on a utility whose wage costs are similarly uncompetitive and unsustainable.

69. SEC therefore believes that a disallowance of a portion of HON's labour costs is required.

70. HON has said that it currently has collective agreements in place with its unions whose terms will continue during the test years. That may be, but as the Board said in the 2007

[7]SEC recognizes that these figures are for Networks as a whole, however, almost all of Networks' total compensation, whether capitalized or not, will be paid by Ontario consumers at some point.

Transmission decision, the Board's job is to assess the reasonableness of contractual obligations. While the applicant is certainly bound by its contractual obligations, the Board is not.

71. It has now been shown that HON's labour costs are not reasonable as compared to comparable employers.

72. In SEC's submission, HON's revenue requirement should be reduced by $13 million in each of 2009 and 2010 to account for the unreasonable labour costs.

73. In making this submission, SEC does not suggest that the median compensation level represents the reasonable level or that any amount above the median should be subject to a disallowance. However, as stated above, the $13 million figure represents only a fraction of the total cost to HON customers from having its compensation above the median.

Total Reduction- OM&A

74. SEC believes that, in total, a reduction in OM&A in the amount of $20 million in each of 2009 and 2010 is warranted. The reduction takes into account our discussion in section 3.1 above regarding HON's work program as well as the discussion in section 3.3 above regarding HON's compensation structure. SEC points out that even with that reduction, HON's OM&A will grow by 11% in 2009 and a further 3.5% in 2010, or 15% over the two years.

4. CAPITAL EXPENDITURES and RATE BASE

4.1 Are the proposed 2009 and 2010 Sustaining and Development and Operations capital expenditures appropriate, including consideration of factors such as system reliability and asset condition?

Development Capital

75. HON has put forward a number of Development capital projects that are related to the Ontario Power Authority's ("OPA's) Integrated Power System Plan ("IPSP"). The IPSP was submitted to the Board for approval in 2007 but soon after the oral hearing to consider the plan was commenced it was adjourned as a result of a directive from the Minister of Energy to the OPA.

76. Of the total Development projects in excess of $3 million for which investment summaries have been provided, 18 are described as Pre-IPSP projects. Of these, eight are either Category 1 projects (projects, such as the Bruce to Milton transmission line, which has already received Board approval in a previous proceeding) or Category 4 projects, which are projects that will require future Board approval. HON has said that it is not seeking approval of these projects at this time, however, information on the projects has been provided in the application so as to inform the Board "of all component that make up Hydro One's capital expenditures in the test years." [Exhibit I-4-33] None of the pre-IPSP category 4 projects, however, have significant expenditures associated with them in the test years.[8]

77. Although Category 3 projects will generally not be coming into service during the test years, HON is requesting approval for those projects in this proceeding. [Tr1:120]

78. SEC's submissions with respect to pre-IPSP Development capital projects, therefore, will be confined to Category 2 and 3 projects. These projects are listed below, along with their anticipated expenditures in the test years:

[8] There are only two such projects, D31 and D22, with total expenditures in 2009 and 2010 between them of $3.6 million- see Exhibit D1-3-3, p. 34, Table 3.

Cat.	Project Code		I/S Date	Basis for Need	2009	2010	Gross Total
2	D3	Inter-Area	2009	OPA Recom*	34.2	0	56.5
2	D4	Inter-Area	2010	OPA Recom*	4	1.7	5.8
2	D7	Inter-Area	2010	OPA Recom*	48.5	54.8	108.6
2	D8	Inter-Area	2010	OPA Recom*	34.2	7.2	47.2
2	D9	Inter-Area	2010	OPA Recom **(pending)**	4.6	5.1	9.7
2	D10	Inter-Area	2010	OPA Recom **(pending)**	2.9	7.4	10.3
3	D11	Inter-Area	2011	OPA Recom **(pending)**	0.8	20.9	31.9
3	D12	Inter-Area	2011	OPA Recom*	0	5.5	14.6
3	D13	Inter-Area	2011	OPA Recom **(pending)**	15.2	44.4	80
3	D14	Inter-Area	2011	OPA Recom **(pending)**	13.1	38.5	69.2
Total					**157.5**	**185.5**	**433.8**

*Recommendation letters provided in response to Undertaking J1.3, Attachments 1,3 and 4.
Source: Exhibit K1.1 and Exhibit D1-3-3, pp. 33-34 (Tables 2 and 3).

79. As can be seen from the table above, the total expenditures for these Category 2 and 3 pre-IPSP projects is $343 million in the test years and $433.8 million in total.

80. SEC has reviewed the recommendations delivered to HON for projects D3, D4, D7, D8, and D12 [Undertaking J1.3, Attachments 1,3 and 4]. SEC's concern with respect to the pre-IPSP projects generally was that they related to aspects of the IPSP that may be changed in view of the Minister's directive and the subsequent introduction of the *Green Energy Act*.

81. However, upon review of the recommendation letters from the OPA, that does not appear to be the case. The May 20, 2008 letter from the OPA for example, which relates to projects D7, D8 and D12, states that the purpose of the projects is to:

> permit increases in the power transfer capabilities between Sudbury and the GTA (the North-South Tie) and between Timmins and Sudbury to meet the near-term need for incorporating new renewable generation in northern Ontario. These projects are consistent with and a component of the longer term transmission

> development plan to increase the transfer capabilities along these two power delivery paths to facilitate the development of the large renewable generation potentials in northern Ontario.
>
> [Undertaking J1.3, Attachment 4]

82. The letter then goes on to list specific hydroelectric projects, totaling 500MW, that will be serviced by the new transmission capability as well as other, unidentified, potential hydroelectric, wind and combined heat and power generation totaling 400MW.

83. In SEC's submission, therefore, the need for these projects, from HON's point of view, has been established.

84. A question remains, however, as to how the cost effectiveness of the projects overall is reviewed. When asked in cross-examination who does the analysis to determine whether a project is cost effective, the HON witness responded that "we would look at the most cost effective…transmission alternative to achieve the purpose that's been put forward to us, but [the] overall cost-effectiveness judgment is not ours to make." [Tr2:15]

85. HON was then asked to produce a cost effectiveness analysis for the transmission components of Exhibit K1.1 projects. HON's response was as follows:

> Hydro One Networks did not provide a cost-effectiveness analysis to the OPA for any of the transmission projects identified in Exhibit K1.1. The OPA is an independent organization that seeks input from various organizations before arriving at their decisions. The information that Hydro One provides to the OPA with regard to transmission projects is the estimated cost of transmission alternatives. We understand that the OPA then uses this input, as well as input from other sources, to conduct their cost-effectiveness analysis.
>
> [Undertaking J2.1]

86. It appears therefore, that these projects are treated by HON as exogenous variables- that is, HON's job is to provide the transmission solution to OPA. The ultimate decision, however, is made by OPA.

87. In SEC's submission, that leads to a legitimate question as to who the ultimate regulator is with respect to this aspect of HON's spending.

88. If HON's position is that the projects are required because they are done at the behest of the OPA, then in SEC's submission HON should be required to provide evidence from the OPA providing either an economic justification for the project or a Ministerial order in respect of the projects. The current situation leaves us with a regulatory gap, with this Board asked to approve projects with very little evidence from the proponents of the projects, the OPA.

Level of Capital Expenditures

89. While SEC accepts that there is a need for significant increases in development capital spending, SEC still has two concerns with the level of HON's projected capital expenditures.

90. First, with respect to HON's capital budget generally, SEC believes there is a serious concern with respect to whether the company can achieve its capital spending program. In 2007, HON spent $152 million less in capital expenditures than the Board approved amount [D1-3-1, p. 4]. In 2008, HON under-spent by $70.2 million [Exhibit K1.6].

91. To achieve its projected 2010 capital expenditures ($1.1 billion), HON will have to increase spending by 39% over the 2008 level.

92. For this reason, SEC supports Board Staff's proposal that a variance account to track the difference between actual achievement in capital expenditures versus forecast. There is considerable reason to believe that HON will not achieve its forecast spending given that a.) spending in the test years is considerably higher than the historical period and b.) HON has experienced considerable under-spending in the past.

93. SEC believes, however, that any variance should be asymmetrical and should only track under-spending. The evidence indicates that ratepayers need to be protected from the very high likelihood that HON will not achieve its forecast. Conversely, ratepayers are not in a position to control the company's level of spending and should not be in a position of providing the utility with an unlimited amount of spending to be recovered in rates.

Non-Development Capital Expenditures

94. Second, SEC believes that when one area of expenditures is increasing substantially, it is imperative to find reductions in other areas. In HON's case, that means finding reductions in non-development capital expenditures to offset the large increases in development capital. In that regard, SEC believes that the concerns expressed above regarding HON's SDO OM&A expenditures- namely, SEC's submission that the condition of the assets does not justify the large increases sought by HON- also apply to HON's proposed non-development capital expenditures.

95. SEC therefore believes that some reduction is required for non-development capital expenditures.

96. HON's forecasted capital expenditures for 2009 and 2010 are $944.0 and $1,074.1 million respectively, with $553.4 and $658.8 million categorized as development capital in each year [D1-3-1, p. 2].

97. Non-development capital expenditures, therefore, total $390.6 million and $415.2 million in 2009 and 2010 respectively. This is an increase of 36% and 44.7%, respectively, over non-development capital expenditures in 2007[9].

98. SEC believes that non-development capital expenditures should be reduced by 10% in each of 2009 and 2010, or $39 million and $41.5 million respectively. The result is 4% overall reduction in capital expenditures in each year- from $944 million to $905 million in 2009 and from $1,074.1 million to $1,032.6 million in 2010. In SEC's submission, that is a relatively minor reduction and well within the range of under-spending that HON has exhibited in the past several years.

4.4 Is the forecast of long term debt for 2008-2010 appropriate?

99. SEC has had a chance to review the submissions of BOMA/LPMA on this issue and agrees with them that the Board's cost of capital parameters refer to the deemed long-term debt rate and not to deemed long term debt.

100. The Board Report on Cost of Capital states as follows:

> The Board has determined that for embedded debt the rate approved in prior Board decisions shall be maintained for the life

[9] 2007 capital expenditures totaled $559.5 million, of which $272.6 million was Development capital. Total non-development capital expenditures in 2007, therefore, equaled $286.9 million, 36% lower than the equivalent figure for 2009 ($390.6 million) and 44.7% lower than for 2010 ($415.2 million).

> of each active instrument, unless a new rate is negotiated, in which case it will be treated as new debt.
>
> The Board has determined that the rate for new debt that is held by a third party will be the prudently negotiated contracted rate. This would include recognition of premiums and discounts.
>
> For new affiliated debt, the Board has determined that the allowed rate will be the lower of the contracted rate and the deemed long-term debt rate. This deemed long-term debt rate will be calculated as the Long Canada Bond Forecast plus an average spread with "A/BBB" rate corporate bond yields.
>
> …
>
> For all variable-rate debt and for all affiliate debt that is callable on demand the Board will use the current deemed long-term debt rate.
>
> [Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors, p. 13-14]

101. The deemed long term rate would only apply to the portion of HON's debt that is either a.) new affiliate debt, if the contracted rate is higher than the deemed rate; or b.) affiliate debt that is callable on demand. It does not appear that any of HON's debt meets that criteria and therefore the contracted rate should apply.

102. It appears that what HON has done is carved out a portion of its capital structure and designated it as "deemed long term debt". Unlike what was done for short-term debt, however, the Board's Report does not designate a specific proportion of utility's capital structure as "deemed long term debt". Rather, what the Report does is determine how the cost rate for the total deemed long-term debt is determined. As mentioned, there are only certain limited circumstances where the deemed long-term debt rate is used, and HON's debt does not fit any of the scenarios set out in the Report.

103. SEC therefore believes that the cost rate for all of HON's long-term debt should be the average cost of its long-term debt shown at line 1 of Exhibit B2-1-1, p.2- i.e. 5.9%. The result is that the amount characterized as "deemed long term debt" in that exhibit would earn a return of 5.9%, or $12.14 million rather than the $15.68 million that would result from using the Board's deemed long-term debt rate of 7.62%.[10]

5. DEFERRAL/VARIANCE ACCOUNTS

5.3 Are the proposed new Deferral/Variance Accounts appropriate?

104. The Company is requesting a new deferral account to record the cost of pre-engineering studies it is conducting for IPSP-related projects.

105. In SEC's submission, the company has not demonstrated a need for this deferral account and it should be rejected.

106. In the first place, the Company has not demonstrated that it is unable to accurately forecast the amounts to be spent on the projects. The company witnesses in fact testified that they were confident in their forecast.

107. Secondly, the Company has also not demonstrated that the amounts to be spent are beyond the company's control.

[10] The return on "deemed long-term debt" used in the pre-filed evidence is $12.7 million, based on a deemed long-term debt rate of 6.2%. However, that has now changed as a result of the Board's new cost of capital parameters published February 24, 2009.

108. In fact, the only reason HON has given for the proposed account is that it faces a compressed timetable to conduct the work "with no assurance that capital assets will in fact materialize as a result of these expenditures." [Ex. F1-1-2, p. 2]

109. In SEC's submission, HON has not established that a deferral account is needed for these expenditures.

110. SEC agrees with AMPCO's submission that these are in fact capital expenditures and should be treated accordingly.

7. CHARGE DETERMINANTS

7.1 Is the proposal to continue with the status quo charge determinants for Network and Connection service appropriate?

111. The Association of Major Power Consumers of Ontario ("AMPCO") has put forward a proposal to change the current rate design methodology for HON transmission customers.

112. Currently, customers' charge determinants are based on the higher of their monthly coincident peak (their demand at the hour of the monthly system peak) or 85% of their non-coincident peak demand, during the peak hours of 7 a.m. to 7 p.m. on working week days.

113. AMPCO seeks to change that methodology with a new "High 5" rate proposal, whereby a customer's charge is determined based on the customer's demand on the 5 days of highest demand in the previous year, regardless of when the five days occur.

114. The main difference between the current methodology and the AMPCO proposal is the elimination of a customer's non-coincident peak demand as a factor in determining its charge determinant.

115. AMPCO believes that doing so will provide a greater incentive for customers to reduce demand during system peak. AMPCO believes that the current system provides a disincentive to reduce demand during peak times. That is because, under the current system a customer can significantly reduce its demand during peak times without reducing its transmission rates.

116. AMPCO believes that providing an incentive to customers to reduce their demand during peak times will result in lower peak demand, which is a key policy objective of the province of Ontario. In addition, lower demand during peak times will result in a lower hourly Ontario electricity price ("HOEP"), which will result in ancillary benefits for all customers.

117. SEC believes that demand response is an important goal and one that should be taken into account in designing rates. It is not, however, the only goal.

118. The first goal of rate design is the goal of full cost recovery: that is, rates should be designed to provide a utility with a reasonable opportunity to recover its revenue requirement.[11] The next goal is the fairness principle, and that is that revenues should be recovered from ratepayers on the basis of the costs they cause on the system. The determination of costs in that context, however, refers to the utility's average costs, not the marginal costs that a user may impose.

[11] See, for example, The Staff Discussion Paper in EB-2007-0031, Rate Design for Recovery of Electricity Distribution Costs, p. 15.

119. Taken in tandem, these two goals together mean that the utility should recover all of its costs, and ratepayers should pay for all of those costs in accordance with the proportion of costs they impose on the system.

120. In SEC's submission, AMPCO's proposal is essentially a marginal cost pricing proposal: that is, the assumption behind the proposal is that because only demand during peak times imposes marginal costs on the system as a whole, only that demand should be considered in determining rates.

121. The essence of rate design, however, and of cost of service rate making generally, is that customers share in the average cost of the system. That is because, while in the short run there are marginal costs from adding capacity as peak demand grows, in the long run, all of the system's assets will have to be replaced. There are, therefore, no true incremental costs in the long run.

122. AMPCO's proposal would allow customers to reduce their transmission bills by moving their demand away from peak times, presumably on the basis that they are reducing the strain on the system at the margin. As an extreme example, customers who completely shift their demand to have no demand on peak days will have a network charge determinant of zero.

123. In SEC's submission, the result is essentially marginal cost pricing, which is contrary to established rate design principles.

124. SEC does believe, however, that demand response is an important policy objective. As such, AMPCO's evidence has raised some issues worthy of further consideration, namely:

(a) to what extent can network charge determinants provide an incentive to reduce demand during peak times that is distinct from the incentive already provided by the market energy price? A related issue is to what extent will designing a network charge determinant to provide an incentive to reduce demand during peak times reward customers for behavior they would have undertaken anyway in response to the commodity price signal?

(b) if network charge determinants can be an effective determinant of peak demand, how can network charge determinants be structured so as to remain consistent with rate design principles?

125. SEC believes, therefore, that the Board should follow up on AMPCO's proposal with a more in depth analysis into these issues.

Costs

126. SEC participated responsibly in this proceeding and cooperated extensively with other parties to reduce the time spent by all concerned. SEC therefore respectfully requests that it be awarded 100% of its reasonably incurred costs.

All of which is respectfully submitted this 24th day of March, 2009:

_____

John De Vellis

Counsel to the School Energy Coalition

Appendix A

Data Values used to construct Line Graphs

Figure 1:

HON Sustaining, Development and Operations OM&A Spending
Source: Exhibit K2.1

	2003	2004	2005	2006	2007	2008	2009	2010
Total Sustaining, Development, Operations	185.5	208.3	211.3	230.0	264.0	244.3	292.8	310.3
Index (2003=100)	100.0	112.3	113.9	124.0	142.3	131.7	157.8	167.3
Total Assuming 3% per year increase	185.5	191.1	196.8	202.7	208.8	215.0	221.5	228.1
Index (2003=100)	100.0	103.0	106.1	109.3	112.6	115.9	119.4	123.0

Figure 2:

HON Total Compensation
Source: C2, Tab 3, Schedule 1 and same exhibit in EB-2007-0681

	PWU		**Society**		**Manager Band 7**	
	Total Comp.	Index	Total Comp.	Index	Total Comp.	Index
2004	$98,822.00	100.0	$96,423.00	100.0	$107,813.00	100.0
2005	$102,324.00	103.5	$69,200.00	71.8	$107,938.00	100.1
2006	$111,439.00	112.8	$95,524.00	99.1	$114,332.00	106.0
2007	$114,782.00	116.2	$98,390.00	102.0	$117,762.00	109.2
2008	$118,226.00	119.6	$101,342.00	105.1	$121,295.00	112.5
2009	$121,772.00	123.2	$104,383.00	108.3	$124,985.00	115.9
2010	$125,425.00	126.9	$107,514.00	111.5	$129,825.00	120.4