AMPCO

VIA RESS AND COURIER

April 8, 2009

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

Dear Ms. Walli:

Re: Hydro One Networks Inc.
Electricity Distribution Rates - Effective May 1, 2009
Board File No. EB-2008-0187

Attached please find the final submissions of AMPCO in the above proceeding.

Please contact me if you have any questions or require any further information.

Sincerely yours,

ORIGINAL SIGNED BY

Adam White

Copies to: Glen MacDonald, Hydro One Networks Inc.
Intervenors (email)

Association of Major Power Consumers in Ontario
www.ampco.org

372 Bay Street, Suite 1702
Toronto, Ontario M5H 2W9

P. 416-260-0280
F. 416-260-0442

ONTARIO ENERGY BOARD

IN THE MATTER OF *the Ontario Energy Board Act, 1998;*

AND IN THE MATTER OF an Application by Hydro One Networks Inc.

For an Order or Orders approving rates for the distribution transmission of electricity

AND IN THE MATTER OF Final Submissions of AMPCO

TABLE OF CONTENTS

ONTARIO ENERGY BOARD

IN THE MATTER OF *the Ontario Energy Board Act, 1998;*

AND IN THE MATTER OF an Application by Hydro One Networks Inc.

For an Order or Orders approving rates for the distribution transmission of electricity

AND IN THE MATTER OF Final Submissions of AMPCO

1. Introduction and Overview

Hydro One is requesting approval of the Ontario Energy Board (the "Board") for a 2009 Distribution Rate increase for its customers that will average more than 4% above the 2008 rates. Hydro One has chosen to make this application using the Board's 3rd Generation Incentive Regulation Mechanism ("3GIRM").

Approximately half of the requested increase can be accounted for by applying the Board's price cap formula and the rider for smart meters. The remaining half of the requested increase would be recovered from customers as a rate rider to support capital costs for which Hydro One seeks approval under the Incremental Capital Module (the "ICM") of 3GIRM.

AMPCO submits that Hydro One's application for 2009 Distribution Rates under 3GIRM represents an inappropriate use of the IRM. Two aspects of Hydro One's application depart substantially from the Board's policy with respect to 3GIRM:

1. Hydro One is applying for approval of rates for a single year pursuant to the 3GIRM whereas the policy of the Board is that the 3GIRM is to apply for 3 years. AMPCO submits that such a short term application effectively diminishes the productivity improvement incentive that is core to IR;

2. Hydro One is seeking relief by way of the ICM for normal ("business as usual") capital programs whereas the ICM was designed to be used for special and unusual needs.

If the Board accepts the Hydro One application it would be approving a hybrid IRM in Ontario, with OM&A being subject to IR, while capital works programs are reviewed in a manner similar to a Cost of Service application, but with less evidentiary support. Such precedent would present asymmetrical incentives that would favour uneconomic capital investment over OM&A activities.

AMPCO submits, therefore, that the Board should refuse the Hydro One application since it has failed to appropriately apply the ICM which is to be used to seek approval of extraordinary capital requirements and the IRM which is to apply for a three (3) year period not a single (1) year.

AMPCO also submits, in the alternative, that if the Board does not refuse this rate application that it should review specifically two capital programs proposed by Hydro One as part of this rate application; namely, new connections and upgrades, and the smart grid.

2. Single Year IRM

AMPCO submits that IRM was developed to award approvals for more than one (1) year to provide LDCs with clear and ongoing incentives to improve productivity and efficiency while creating regulatory certainty and a reduction in the regulatory burden for applicants, the Board and intervenors.

The Board set the term in its Report of July 14, 2008:

"**The Board has determined that the plan term for 3GIRM will be <u>fixed</u> at three years** (i.e., rebasing year plus three years). The rates of the distributor are not expected to be subject to rebasing before the end of the plan term other than through an eligible off-ramp."

> Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, July 14, 2008; Exhibit K1-3 (K1-13)

Hydro One announced prior to this hearing that it will be seeking approval from the Board by way of a cost of service application for 2010 for 2011 rates, making this an application for approval of rates for a single year.

> Transcript, Vol. 1, page 167, lines 20-21

Hydro One has been explicit in its intent to limit this use of 3GIRM to a single (1) year, notwithstanding the clear policy of the Board.

3. Appropriate Use of ICM

Of the $460.8M in proposed capital spending, very few elements are new or show substantial increases above actual 2008 costs. More than 95% of Hydro One's proposed capital budget is for ongoing programs, not the unusual or extraordinary matters which AMPCO believes the Board designed the ICM to address. Use of the ICM in this way does not promote productivity or efficiency and may discourage it.

Exhibit B1/Tab 3/Schedule 3, page 9 of 19, section 1.14

Exhibit B1/ Tab 3/ Schedule 3, page 18 of 19, section 1.2.4

In its September 17, 2008 Report, the Board addressed the differences of opinion between distributors and customer representatives with respect to the purpose of the ICM. The Board clearly stated that " The intent is not to have an IR regime under which distributors would habitually have their CAPEX reviewed to determine whether their rates are adequate to support the required funding". The Report notes that such use of the ICM would fit a targeted OM&A or "hybrid" form of IR.

Supplemental Report of the Board, September 17, 2008, page 31, first paragraph.

Hydro One takes the position that it is compliant with the wording of the Board report, in that it does not seek to add directly the capital costs to rate base in 2009, but rather is following the Board policy and receiving revenue only on the amount above the threshold; however, Hydro One has confirmed that the difference between the full year treatment for capital above the threshold versus the half year treatment it would receive on the full program if this were a cost of service application is effectively "a wash".

Transcript, Volume 2, page 5, line 27 to page 6, line 4

AMPCO submits that the Board should not approve Hydro One's application herein to use the ICM for its regular capital work program. Such an approval would establish a precedent for a hybrid IR regime, creating a situation which the Board has sought to avoid with its 3GRIM policy. Such a hybrid model would incent uneconomic capital investments in plant and technology in order to relieve the downward pressure on OM&A.

Report of the Board, July 14, 2008, page 6

More evidence of the fact that Hydro One has misused the 3GIRM and misapplied the ICM can be seen from the fact that 3GIRM does not require an applicant to include load and economic forecasts in their application. Similarly, reliability performance and asset condition assessments are not provided as part of a 3GIRM application. This is not surprising, since ICM should be used for specific, unusual, extraordinary projects, not the continuation of the norm.

Hydro One, however, in this application is seeking approval by way of the ICM for ongoing programs that have drivers in load growth, asset condition, asset age, etc. If approval of these capital programs were sought by Hydro One by way of a cost of service application, they would be required to provide the load and economic forecasts to establish that they were being efficient, prudent and cost effective in these programs. Intervenors would be able to test this evidence and provide the Board with their submissions as to whether Hydro One has, in fact, been prudent and efficient.

Transcript, Volume 1, page 130, lines 20-24

Hydro One asserts that 3GIRM does not require this information and so the capital programs for which it applies herein are not supported by such information.

Transcript, Volume 1, page 129, line 1, page 130, line 9;

AMPCO submits that the Board should reject Hydro One's use of the ICM in this application.

The replacement of PCB contaminated transformers appears to be the only program proposed that is both new and clearly non-discretionary.

Exhibit B1/Tab 3/Schedule 3, page 9 of 19, section 1.14

Exhibit B1/Tab 3/Schedule 3, page 18 of 19, section 1.2.4

The replacement of PCB contaminated padmount transformers and the smart grid and CDM programs are the only capital programs proposed in this application by Hydro One for which Hydro One did not seek approval in 2007 or 2008. These four programs have a total proposed budget (respectively) of $10.2M +$1.0M+$6.8M+$0.6M for a total of $18.6M; approximately 4% of the total capital program for which Hydro One seeks approval herein.

Exhibit I/Tab 8/Schedule 5, page 2

This point that Hydro One's regular capital programs and not unusual requirements is driving the spending level that exceeds the ICM threshold, was reinforced in Mr. Lokan's exhibit for cross examination, which clearly shows that, since at least 2002, Hydro One's capital program has substantially exceeded depreciation. Mr. Somerville received confirmation of this "abiding condition" in his questioning of the witness panel. Dr. Poray verified that this condition is in fact growing.

Exhibit K 2.1

Transcript, Volume 2, page 117, line 26 to page 118, line 7

4. The Economic Impact on Hydro One if the Board rejected use of ICM

AMPCO's submits that the Board should not allow Hydro One's proposed use of the ICM to fund non-exceptional work programs above the threshold.

As discussed previously, the only exceptional capital work programs in Hydro One's application that are fully non-discretionary are the programs to replace transformers with PCB concentrations above 500ppm. The total cost of these programs are $11.2M. The proposed CAPEX with the corresponding revenue requirement would not appear to be material enough to justify using the ICM, given Hydro One's approximately $1B revenue requirement.

Exhibit I/Tab 8/Schedule 5, page 2

Exhibit A/Tab 2/Schedule 1, page 1, paragraph 3

AMPCO submits that Hydro One's use of the ICM should be rejected by the Board since its use in this application is a misapplication of the principles which led to its development. AMPCO also submits that rejecting the use of the ICM will have no material economic impact on Ontario Hydro.

Hydro One's requested rate rider for incremental capital is $21.32M, or approximately 2% of its revenue requirement.

Exhibit B1/Tab 2/Schedule 1, Table 1

This figure does not represent the actual impact on Hydro One of the rejection of its ICM application.

AMPCO submits below that the New Connections and Upgrade program be reduced by 10% from 2008 actual costs to reflect declining housing starts and economic activity, and that the smart grid pilot projects be deferred until the Board develops standards and processes for implementation.

If accepted by the Board, these two changes to Hydro One's proposal would reduce the capital program as follows:

10% Reduction in New Connection and Upgrades: $101.8M X 0.10 = $10.18M
Discontinue Smart Grid Pilots: $6.8M
Total Capital reduction: $16.98M

This represents just slightly less than 10% of the $173.7M incremental CAPEX being requested. In turn, reducing the incremental CAPEX by this amount should result in a corresponding reduction in the $21.3M Incremental Revenue Requirement of approximately 10%, or about $2M.

Exhibit I/Tab 8/Schedule 5, page 2 of 3
Exhibit B2/Tab 1/Schedule 2/Appendix F, page 8 of 8.

Other intervenors have identified other proposed CAPEX which could be reduced or eliminated which, if accepted by the Board, would have the effect of either reducing the amount of capital within the ICM module, or reducing the revenue required to support the ICM level.

For example, Schools Energy Coalition's ("SEC") cross examination noted that, updating the application with the correct price cap index would increase the threshold for the ICM by over $7M and, therefore, reduce the amount in the ICM by the same amount. This would have the effect of reducing the revenue requirement by approximately $1M, according to Hydro One.

Transcript, Volume 1, page 107, line 25 to page 109, line 27

Also, Canadian Manufacturers and Exporters ("CME") and SEC noted that the cost of capital in 2009 will actually be lower than the cost used in the IRM model, yielding a further reduction that may be in excess of $700K.

Transcript Volume 1, page 121, line 25 to page 123, line 1.

Considering only the effect of eliminating and reducing the programs recommended by AMPCO and the calculation issues noted by CME and SEC, the impact on Hydro One of not having its ICM approved drops by approximately $2M +$1M+0.7M = $3.7M. This would reduce the impact on Hydro One from $21.3M to $17.6M.

This amount is less than 2% of Hydro One's revenue requirement of approximately $1B. Also, it is in the same range as other uncertainties, such as spending levels. For example, Hydro One's distribution OM&A cost dropped by 3% between 2007 and 2008 ($549M vs $531M), a difference of $18M.

Hydro One 2008 Annual Consolidated Financial Statements

Since Hydro one has indicated it plans to return to the Board this summer with a cost of service application for 2010 rates, if the Board were to refuse this application because of the use of the ICM by Hydro One, the impact will be very short-lived.

5. New Connections and Upgrades

These CAPEX include the cost of connecting new customers, upgrading connections to existing customers and service cancellations. The program is non-discretionary.

Hydro One is proposing to spend $110.1M on new connections and upgrades in 2009. This represents an increase of $8.3M or more than 8% over the 2008 actual level of spending in this area of $101.8M. In 2008, costs were $4.1M below the 2007 level of $105.9M.

This account is driven primarily by new housing, which is also a driver for other new connections such as streetlights and new local businesses.

Exhibit I/ Tab8/ Schedule 5, Page 2

In response to an AMPCO interrogatory, Hydro One stated that its expectation of new housing starts for 2008 were 68,000 and for 2009 are 70,300. In cross examination, Hydro One was asked whether this was overly optimistic in light of the recession. The witness acknowledged that the forecast now is probably lower, but that 3GIRM does not provide for an update of the load forecast. The witness also emphasized that there is typically a nine month lag until changing business conditions are felt in new connection activity due to the length of the development process. The witness went on to suggest that the effect of the downturn would be felt in 2010, not 2009.

Exhibit I/Tab 5/ Schedule 8, page 1, lines 28-29

Transcript, Volume 2, page 80, line 3 to page 81, line 25

AMPCO submits that Hydro One's claim that new connection and upgrade activity will increase in 2009 by 8% while the economy is in serious recession is not supported by the evidence. The recession began well before the start of 2009 and every homeowner knows that housing markets have been depressed for months. A nine month lag cannot delay a drop in new connections from the fall of 2008 into 2010.

Hydro One's claim that 3GIRM does not require that it provide load forecasts to support its application should not excuse it from developing up to date information to estimate the costs of this program. The Board is clear in its filing guidelines that the amounts requested must be directly related to the claimed driver.

Supplemental Report of the Board, Sept 17, 2008, Table 5

AMPCO submits that the amount Hydro One is requesting for new connections and upgrades is excessive and is not supported by the evidence. The uncertainty in what actual connections and upgrades will be required is a consequence of Hydro One's failure to provide an up to date analysis and projection of customer activity.

AMPCO submits that this program does not require a funding increase beyond the 2008 actual costs and should more realistically be funded at 10% below 2008 actual costs.

6. Smart Grid

Hydro One is proposing to spend $6.8M in 2009 on it s smart grid project. The company has identified that this will provide funding for three pilot projects. These pilot projects appear to focus on enablement of distributed generation, remote control of reclosers and monitoring of the distribution system.

Exhibit B1/Tab 3/Schedule 7, pages 19 & 20

AMPCO acknowledges that a smart grid will be needed in the future.

When this application was prepared, however, the Green Energy and Economy Act ("GEA") had not been introduced. As the Board and Hydro One are aware, the Board is charged in the GEA with facilitating the development of a smart grid. The Lieutenant Governor in Council, through regulation can issue directives with respect to the timing of implementation, roles and responsibilities and technical standards. As well as the functions Hydro One proposes for its smart grid pilot projects, the Act defines a smart grid's functionality as including "expanding opportunities to provide demand response, price information and load control to electricity customers":

> Transcript, Volume 2, page 76, line 15 to page 79, line 4
> Green Energy Act, pages 17-18 Schedule B (amendments to Electricity Act 1998) Section 1(5)
> Green Energy Act, page 28, Schedule D (amendments to Energy Board Act, 1998). Section 1, paragraph 4

It appears that the Board will have the responsibility under the GEA to establish the functional requirements and technical standards for the smart grid and to develop the mechanisms by which Ontario consumers pay for it.

While Hydro One's desire to take the initiative in developing the smart grid may be laudable, AMPCO submits that it is ill advised in the current circumstance for these reasons:

a) by starting now, Hydro One may be setting de facto standards for Ontario, which could be at odds with those developed pursuant to the province as a whole;

b) the Hydro One pilot projects that are proposed pursuant to this application do not include all the functional requirements described in the GEA and may result in investments that will not become used and useful when smart grid standards that do meet all the requirements of the GEA are developed;

c) by moving in advance of Board development of standards and requirements, Hydro One's projects may provide an unfair competitive advantage to whichever vendors Hydro One selects for its project(s);

d) Hydro One's project costs as proposed, will be recovered from its distribution customers via Hydro One distribution rates. This may not reflect the actual method of cost allocation that will ultimately be established by the Board pursuant to the GEA;

e) The GEA refers to a smart grid in the singular. Presumably, this will mean either a single smart grid system or compatible systems. Any smart grid projects developed now by Hydro One may not meet these standards and, as such, be of no enduring value.

AMPCO submits, therefore, that the Board not allow Hydro One funding for this project, at this time. Funding any smart grid program should follow passage of the GEA and any regulations made thereunder to describe the implementation of the program.

7. Summary of AMPCO's Submissions

In summary, AMPCO makes the following submissions to the Board:

a) Hydro One has misapplied the 3GIRM by,

i.) applying for approval of rates for a single year;

ii.) seeking relief by way of the ICM for regular, not special or unusual capital projects.

b) AMPCO requests, therefore, that the Board refuse this rate application of Hydro One;

c) AMPCO submits that refusal of this rate application will have no material economic impact on Ontario Hydro;

d) AMPCO submits that any impact of refusing this rate application will be short lived;

e) AMPCO submits, in the alternative, if the Board is not prepared to refuse this rate application any funding increases approved for new connections and upgrades should be at a level 10% below actual costs incurred by Hydro One in 2008;

f) AMPCO submits that the Board not allow Hydro One funding for the smart grid program since it is premature and any such program should await the proclamation of the GEA and any regulations made thereunder which pertain to this program.

8. Costs

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

ALL OF WHICH IS RESPECTFULLY submitted this 8th April, 2009.

David Crocker
Counsel to AMPCO

Davis:4776691.1