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File 17834

February 5, 2010

VIA COURIER and *RESS FILING*

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

Dear Ms. Walli

Re: Hydro One Networks Inc. Board File EB-2009-0096
2010 and 2011 Distribution Rate Application
Final Argument of Power Workers' Union

Attached please find the Power Workers' Union's final submission in the above proceeding.

Yours very truly,
PALIARE ROLAND ROSENBERG ROTHSTEIN LLP

Richard P. Stephenson

RPS:jr

encl.
cc John Sprackett, PWU
Judy Kwik, ERA
Hydro One and Intervenors

Doc 747728v1

EB-2009-0096

Power Workers' Union
Final Argument

February 5, 2010

EB-2009-0096

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. for an order approving just and reasonable rates and other charges for electricity distribution for 2010 and 2011.

SUBMISSIONS OF THE POWER WORKERS' UNION

The Power Workers' Union ("PWU") makes the submissions below on issues 1.3, 1.5, 3.1, 3.2, 3.5, 4.2, 9.1 and 9.3.

A. GENERAL

I. SERVICE QUALITY

Issue 1.3 Is service quality, based on the OEB specified performance indicators, acceptable?

1. The PWU has concerns with respect to three service quality issues. First, while the PWU acknowledges Hydro One's performance in the area of employee and public safety, the Company's performance in the area of distribution reliability is not satisfactory. According to some benchmarking studies such as First Quartile's and others, Hydro One's distribution reliability has been at the bottom quartile, on such indicators as System Average Interruption Duration Index ("SAIDI") and System Average Interruption Frequency Index ("SAIFI").

2. While recognizing the contribution of the rural nature of Hydro One's service territory to this level of performance, there should be an understanding that there is considerable room for improvement, particularly if the level of requested funding to transition to a shorter vegetation management cycle and correction of defective equipment is approved. For example, defective equipment was responsible for 27% of SAIFI for the period 2005-2008.[1] According to Hydro One, this performance could be improved by improving programs and increased funding[2]. Hydro One has indicated that it has deferred large numbers of system defects since 2005 and that while this "has not, to date, resulted in an increase to equipment caused outage levels" Hydro One is of the view that this situation cannot be sustained indefinitely.[3] The PWU concurs in this view.

3. Therefore, with regard to approval of Hydro One's proposed revenue requirement, the PWU submits that the Board ought to approve the proposed vegetation management cycle and correction of defective equipment budgets.

4. The second issue of concern to the PWU deals with the manner in which Hydro One applies the Ontario Energy Board's ("OEB" or the "Board") service quality targets year over year. The PWU submits that Hydro One should base its test year service reliability performance targets on the year over year performance improvement required to meet its corporate objective of achieving first quartile performance in its Five-Year Vision embedded in its planning process and proposed revenue requirement. In any case, Hydro One should not include in its performance targets levels of performance that allow for the deterioration of service reliability. Hydro One should therefore not include its lowest performance of the three historic years in its performance target.

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[1] EB-2009-0096, Exhibit A, Tab 4, Schedule 1, Page 20, Figure 5

[2] Ibid, Exhibit H, Tab 6, Schedule 1, Page 2

[3] Ibid, Tab 1, Schedule 21

5. In setting its annual service quality targets Hydro One applies its interpretation of the OEB guidelines[4]. Hydro One's interpretation of the OEB guidelines in estimating the annual targets is to take the largest value of the past three years (i.e. the worst performance level) as the lowest level of the target range. The OEB guidelines require a distributor "that has at least 3 years of data…" to "at minimum, remain within its range of historical performance"[5]. By definition using the OEB guidelines as targets for the 2010 – 2011 test years therefore does not necessarily target improvement in service reliability, and in fact could target lower performance in the test year compared to the current performance. As an illustration, Hydro One's 2009 OEB target for SAIFI is $\leq$ 3.6, compared to its actual SAIFI performance of 3.5 in 2008. While Hydro One's target range is set according to a plausible interpretation of the wording of the Board's guidelines, in the PWU's view it is highly unlikely that it was the intent of the OEB's guidelines to permit a systemic service reliability deterioration.

6. Hydro One's strategic objective for its Five-Year Vision embedded in its work programs is to "Achieve top-quartile distribution reliability (like with like)"[6] service reliability. Hydro One's Five-Year Vision associated with its strategic objective to be in the top quartile of comparable utilities requires it to improve reliability performance (i.e. lower SAIDI, SAIFI and Customer Average Interruption Duration Index values) over its 2006-2007 performance.

7. With regard to the issue of service quality, the PWU submits that the Board should direct Hydro One, in its future rate applications, to establish and report based on targets that reflect maintenance of existing performance levels, or improved levels: but not the lowest performance achievement of the last three-years. This will ensure that Hydro One's targets do not include levels that represent performance deterioration.

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[4] EB-2009-0096, Exhibit A, Tab 15, Schedule 1, Page 10, Line 15

[5] 2006 Electricity Distribution Rate Handbook. May 11, 2005. Chapter 15 – Service Quality Regulation, pgs 140-143.
http://www.oeb.gov.on.ca/documents/edr_final_ratehandbook_110505.pdf

[6] EB-2009-0096, Exhibit A, Tab 4, Schedule 1, Page 3, Table 1

8. The third issue relates to Hydro One's definition of force majeure. Hydro One deems a force majeure to have occurred when 10% or more of its customers have been interrupted by an event[7]. The PWU understands that Hydro One also used this definition in the 2006 and 2008 distribution cost of service applications. By its nature, this definition focuses on the consequences of a system failure, rather than the cause.

9. With regard to force majeure Board Staff pointed out in the past:

> **…*force majeure* events are generally referred to as those events that are beyond the reasonable control of the firm, including natural disasters such as tornados, earthquakes, hurricanes, flood, other acts of God, acts of any Government, civil disorder, or similar incidents.**[8]

10. Similarly, counsel for the PWU pointed out during cross examination that the term is akin to an act of God, something upon which the person that is responsible for doing something has no control over. This is not how Hydro One defines the term. Hydro One's witness conceded that technically speaking, the Company's definition differs, in that it defines force majeure based on a specified percentage of customers that are affected by the event. Asked to confirm that once the 10% criterion is met that there would be no assessment made, whatsoever, as to the actual cause of the outage, Hydro One's witness replied:

> **That's fair. However, I don't think, in my experience, I've ever seen an event that hits our force majeure that doesn't start to look a whole lot like an act of God.**[9]

11. Of course, there is no logical reason why an outage affecting more than 10% of customers could not arise from a cause that is wholly or largely within the control of the utility, whether from equipment failures, vegetation management practices or substandard maintenance practices.

[7] EB-2009-0096, Exhibit A, Tab 15, Schedule 1, Page 1

[8] EB-2007-0681, Exhibit H, Tab 1, Schedule 43

[9] EB-2009-0096, Transcript, Volume 5, Page 43, Lines 1-4

12. Hydro One admits that the 10% force majeure protocol is not a standard in the electric utility industry and in fact states that, in the absence of an industry standard, it believes the 10% criterion to be reasonable[10]. Hydro One also mentions six US-based commissions and a few utilities as comparable organizations that use the 10% criteria[11]. It is not clear from Hydro One's response, however, if these commissions and utilities define the term using the 10% criteria as it relates to the size of customer base impacted together with the nature of the event that makes it force majeure.

13. The PWU is concerned that Hydro One's reliability report using SAIDI and SAIFI indicators as "including force majeure" and "excluding force majeure" can be misleading given the generally accepted definition and understanding of force majeure. It also undermines the comparability of Hydro One's reliability statistics relative to other Ontario LDC's that use a different definition of force majeure. The definition also leads to the very anomalous result, whereby the worse the impact of the system failure for Hydro One's customers, the less the consequences to Hydro One in terms of its reliability performance statistics. Hydro One's definition relates to the outcome or level of damage regardless of cause and renders the Company harmless (from the point of view of reliability statistics) with regard to service interruptions to over 10% of its customers. This is so because Hydro One's definition of force majeure does not require the Company to investigate or assess the actual cause of the outage once damage is assessed at over the 10% threshold.

14. Hydro One's 10% criterion ignores consideration of the intensity of the impact of a storm event on the local area hit to establish the event as a force majeure. Instead, inconsistent with the common understanding of a force majeure, the criterion applies a broad geographic statistic to define a force majeure event. While it is true that the most common causes of outages for Hydro One in this category have been storms, it ought not to be the basis for

[10] EB-2009-0096, Exhibit H, Tab 1, Schedule 5, Page 1

[11] Ibid.

precluding from the service quality performance metrics events that under normal circumstances should be considered as being in control of the company that would interrupt power for over 10% of customers. Hydro One conceded that system condition is relevant to the nature of the impact suffered by the system as a result of severe weather events. All things being equal, a system that is older or weaker (for example, by virtue of maintenance deferrals) will suffer outages which are wider and lengthier than on a system which is more robust.[12]

15. Service quality performance is an indicator of a distributor's output, a fundamental consideration in the determination of the reasonableness of a distributor's proposed input i.e. costs. It is therefore essential that criteria used in establishing metrics intended as indicators of a distributor's service quality performance are comprehensible and transparent. Therefore, for the purpose of reporting service quality and reliability in its rate applications, the PWU, recommends that the Board direct Hydro One to use a definition of force majeure that is consistent with the ordinary understanding of that term. In particular, if Hydro One is to exclude events from its reliability statistics, it may only do so on the basis that the cause of the event has been investigated and has been determined to be an event beyond its control and the percentage of its customers that are affected by that event is 10% or more.

II. REVENUE REQUIREMENT & RATE IMPACT

Issue 1.5 Is the overall increase in 2010 and 2011 revenue requirement reasonable given the impact on consumers?

16. The PWU submits that it would be wrong for Hydro One to seek to achieve some short-term rate objective by placing undue burden on future rates and future rate payers. The PWU is of the view that Hydro One has struck the appropriate balance between its ongoing operational needs and current rate impacts. The Board should reject submissions which subordinate the integrity of

[12] I think the Hydro One witness agreed with this point in my cross examination.

the distribution system as well as the service quality, reliability and rates of future ratepayers to a fixation on short term rate impacts.

17. There are a series of factors, all of which lead to the unavoidable conclusion that Hydro One's costs and rates will continue to rise for the foreseeable future. As a result, any deferral of costs to future periods, will only result in future ratepayers facing even higher rates and being unfairly burdened with costs that should be shared by current ratepayers. Some examples of the factors leading to higher future costs and rates include:

a. The rate base is going to continue to increase for the foreseeable future due to a larger work program[13] and increased costs;

b. Hydro One's aging infrastructure has more assets reaching end-of-life now than ten years ago which means they have to be replaced at a faster rate because of the vintage of the asset pool (e.g. wood poles);

c. The increase in cost that Hydro One is experiencing is not a short-term issue that is going to be resolved. Costs are expected to increase (i.e. labour, component costs, commodity costs, short-term debt rate, long-term debt rate and return on equity); and

d. Green Energy Initiatives are another source of increased costs for Hydro One. Hydro One has been directed to undertake Green Energy Plan ("GEP") projects which place additional financial pressures on the Company related to the very large GEP capital projects. In order to derive the benefits of the GEP initiatives there will be a cost on the distribution system in facilitating renewable generation that will need to be recovered.

[13] EB-2009-0096, Transcript, Volume 4, Page 67

18. The unfortunate fact is that expensive Government policy initiatives are being launched at a time when an under-funded and aging network infrastructure requires unprecedented levels of capital investment over the foreseeable future.

19. On the positive side,

a. Hydro One has already expressed its willingness to consider an alternative funding approach to its GEP, in particular, a "funding adder" with a variance account (provided that the Company is assured certainty of revenue recovery). Such alternative approach surely helps in mitigating rate impacts.

b. A significantly smaller proportion of the cost of the GEP is anticipated to be collected from Hydro One customers while the lion's share is assumed to be recovered through external funding. Based on Hydro One's assumption, the following is proposed:

Green Energy Plan Cost Applicable to Hydro One's Distribution Customers

	2010		2011		2012-2014	
	OM&A	Capital	OM&A	Capital	OM&A	Capital
Renewable Generation	3	16	3	33	10	110
Smart Grid (SG)	10	30	10	62	45	250
Total	13	46	13	95	55	360

20. If projects are deferred with the goal of deferring costs, they will be deferred to an environment of even higher costs than today's. This was confirmed by a Hydro One witness:

> **We believe that the work that we are putting forward here is work that is necessary. We don't believe that delaying it will be economically beneficial to our customers. We believe that costs will increase, and we believe that this is probably the best time to do that work from the perspective of**

> **actually getting the work done and ensuring that it is done in the most cost-effective manner for our customers.**[14]

It should be clear that as unfortunate as the current economic conditions including loss of manufacturing jobs are, there have been a number of factors that have contributed to relatively lower electricity prices including historically low interest rates, low inflation, low demand for electricity due to the very economic conditions that are blamed for closure of manufacturing and commercial activities, and the availability of less expensive baseload generation.

21. There is no question that the price of electricity will go up once economic conditions improve (note that jobs normally lag behind other indicators of economic recovery), coal generation closes down, more and more expensive renewable generation under contract comes online (the bill impact of which is in the control of neither Hydro One nor the Board), interest rates and inflation go up, etc. On the other hand, the investment that is required to comply with government directives as well as to maintain a deteriorating infrastructure has to be made now and now is the best time to undertake the projects from a cost perspective.

22. Some intervenors have raised concerns with the rate impact resulting from the application of the Board's Cost of Capital report in this proceeding. The PWU submits that once the Board is satisfied that the methodology prescribed by the Cost of Capital report appropriately reflects Hydro One's cost of capital, those costs will have to be recovered. Moreover, the PWU submits that it would be wrong for the Board to disallow otherwise allowable (i.e. prudently incurred) costs for Hydro One as a means of mitigating the rate impact caused by the Cost of Capital report. By disallowing other expenses (while permitting the cost of capital expenses), the Board would be doing indirectly that which it is prohibited from doing directly. If implementing the Board's revised approach to the determination of cost of capital results in a rate impact that exceeds a rate mitigation threshold,

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[14] EB-2009-0096, Transcript, Volume 3, Page 73

the Board would need to provide for a deferral account such that Hydro One remains financially whole with regard to the rate mitigation.

23. The PWU understands that the Board, by virtue of its jurisdiction and mandate, is confronted by a number of competing objectives in discharging its duties. These competing objectives include the promotion and implementation of government policy, reliability and safety of the system, the financial well being of the utilities and the rate impact on consumers. Obviously, many of these objectives like the government's GEP (e.g. the number, types and cost of renewable generation; the government directive for increased investment in infrastructure to accommodate green energy; etc.) are costly to achieve and are beyond the control of the Board.

24. It is true the current economic circumstances and the concern over the rate impact of the proposed revenue requirement may reinforce the Board's duty to be vigilant when testing the prudence of proposed budgets based on the evidence before it. However, once prudence has been established, the Board will need to ensure that the utility is able to collect the necessary funds. The PWU submits that the evidence before the Board in this proceeding supports a prudency test of the proposed budgets, particularly given the efficiency initiatives that Hydro One has pursued.

B. OPERATIONS, MAINTENANCE AND ADMINISTRATION COSTS

I. Overall 2010/2011 OM&A Costs

Issue 3.1 Are the overall levels of 2010/2011 Operation, Maintenance and Administration budgets appropriate?

25. The PWU submits that Hydro One's overall proposed levels of the 2010/2011 OM&A budgets are appropriate.

26. The context for Hydro One's proposed expenditures in OM&A is that the Company's challenges have increased compared to those presented in the last Distribution and Transmission filings. These challenges include:

a. The initiatives related to the *Green Energy and Green Economy Act, 2009* ("GEGEA");

b. Significant growth in work programs;

c. The need to address assets nearing their end-of-life;

d. An increasing need for additional resources to accommodate the substantial growth in work programs; and

e. Aging staff demographics coupled with a highly competitive labour market due to worldwide scarcity of core skills in the electricity industry.

27. Hydro One's proposed total OM&A expenditures for 2010 are increasing by $32.9m or 6.2% over the projected 2009 bridge year expenditures (a year of Incentive Regulation ("IR") rate adjustment) and total OM&A expenditures in 2011 increase by $15.2m or 2.7% over 2010.[15]

28. The most significant contributor to the increase in OM&A expenditures is a growth in sustainment expenditures, driven primarily by increased vegetation management spending required to cost-effectively address reliability concerns. These expenditures also address, in part, the findings of the Vegetation Management Benchmarking Study ("Vegetation Benchmarking Study")[16] that the Board directed Hydro One to undertake.[17] Other sustainment expenditures are needed to inspect and test oil-filled equipment to meet requirements set out by new PCB regulations, as well as increased efforts on line maintenance to manage system reliability and safety. The development OM&A expenditures are

[15] EB-2009-0096, Exhibit C1, Tab 2, Schedule 1, Page 2, Table 1

[16] Ibid, Exhibit A, Tab 15, Schedule 2, Attachment 1

[17] This issue will be discussed in more detail below.

primarily due to the work required to integrate distributed generation and an increased focus on smart grid, as required by the GEGEA.

29. The PWU has reviewed Board Staff's submission on Hydro One's proposed OM&A expenditures. Board Staff is of the view that the proposed amounts are significantly higher than the 2008 actual amounts and therefore the Board should reduce the proposed OM&A budget by at least $33m[18], an amount which Board Staff indicates is half of the $66m which otherwise would have been reduced for each of the 2010 and 2011 test years had Hydro One's proposed OM&A expenditures been based on a 3% cost escalation assumption. Board Staff identifies a number of reasons for its submission to which the PWU responds as follows.

a. OM&A cost increases from 2008 are very high.

30. Board Staff states:

> **While the percentage change for each of the 4 years do not appear at first glance to be excessive, Board staff notes that the 2010 increase over the Board approved 2008 level (of $466 million), is 20% over that two year period.[19]**

The PWU submits that Board Staff's view above illustrates an unwarranted focus on percentage changes as the most important factor in allowing or denying proposed expenditures. Moreover, Board Staff concedes that the year-over-year changes do not appear to be excessive but then singles out the 20% increase from the 2008 amounts as supporting its view.

31. In fact, the comparison of Hydro One's costs for the test years relative to its historical costs are of only limited value in assessing the reasonableness of those costs. A comparison of costs over time can be a valuable exercise when a utility is operating as a "steady-state". However, that is simply not the situation for Hydro One. Hydro One is facing unprecedented demands upon it from a variety of sources. As a result, it is in a significant "growth mode". The Board

[18] EB-2009-0096, Board Staff Submissions, February 1, 2010, Page 10

[19] Ibid., Page 5

received evidence that the overwhelming cause of the increase in costs arose by virtue of the fact that Hydro One has become and continues to become a much bigger company than it had been in the past. Its costs have increased because it is doing much more than it has in the past. To compare past and future costs is simply not an "apples to apples" comparison.

b. Inflation and Cost Escalation are Lower than Forecast in the Application

32. The variance identified by Board Staff between the inflation and cost escalation in the application and the latest updates should not be exaggerated. For example, as can be seen from the following table[20] comparing CPI in the application and the updated forecasts, the variance is insignificant.

		Historic			Bridge	Test	
		2006	**2007**	**2008**	**2009**	**2010**	**2011**
Original Filing - Global December 2008	**Distribution Cost Escalation for Construction (%)**	7.9	3.7	4.8	1.8	1.3	1.3
	Distribution Cost Escalation for Operations & Maintenance (%)	6.5	3.5	2.1	2.7	-0.1	1.0
Updated - Global August 2009	**Distribution Cost Escalation for Construction (%)**	7.9	3.7	9.2	0.9	-0.1	1.4
	Distribution Cost Escalation for Operations & Maintenance (%)	6.5	3.5	7.6	-2.3	0.1	2.3

33. With respect to cost escalation, the variance for 2010 is insignificant and for 2011, the updated cost escalation figures are actually higher than those filed

[20] Compiled from EB-2009-0096, Exhibit A, Tab 14, Schedule 3 and Exhibit H, Tab 3, Schedule 1

in the original application. The PWU acknowledges the relatively significant variance in the year 2009 and its impact on subsequent years. Nevertheless, the value of cost escalation must be assessed in context. Unit cost increases are a relatively small contributing factor in the overall cost increases; the major reason is an overall increase in the number and size of work programs. Board Staff's submission ignores this increase in scope of work, which is surprising, given that this is the very reason why Hydro One made this cost of service application rather than proceeding with 3rd Generation Incentive Regulation Mechanism ("IRM").

34. Board Staff's submission relating to cost escalations and inflation also ignores Hydro One's plan to increase accomplishment in vegetation management by transitioning to a shorter cycle. By increasing accomplishment in the near term (thereby incurring the associated costs), Hydro One will be able to reduce long term costs associated with maintaining the short cycle in the future. The PWU submits that this is an example of appropriate stewardship that should be a model for Hydro One's capital and maintenance programs.

35. In fact, CPI and general levels of cost escalation have a limited role with respect to many aspects of Hydro One's costs. In particular:

a. The CPI, an index of consumer costs, is not an accurate measure of electricity distribution costs. The Board must be aware of this fact from its experience in developing its IR framework for the electricity distributors;

b. The Board received evidence that Hydro One costs for many of its inputs are the subject of demand/supply imbalances and are increasing at a rate significantly higher than the general rate of inflation. This applies to components, materials and labour;

c. The compensation issue is discussed in more detail elsewhere in this submission, however, it is clear that these costs depend on factors wholly unrelated to the general level of inflation as measured by the CPI. Changes to Hydro One's compensation costs are driven largely by the demand and supply of that commodity, not the general level of inflation as measured by CPI; and

d. The fact is that Hydro One, because of its demographic issues, its growth as a company and North American wide shortages of skilled labour, is facing a demand/supply imbalance. Notwithstanding this fact, Hydro One has succeeded in maintaining the escalation in its labour rates to levels *lower than* the prevailing increases in labour rates in the economy. Hydro One should be rewarded for this accomplishment, not punished for it.

c. OM&A cost per customer and cost per circuit Km are rising significantly and the benchmarking measure showed Hydro One at the top in one measure and in the middle of the range in the other.

36. The PWU acknowledges that Hydro One's cost per customer and per circuit Km has increased over the 2008 amounts. However, it is not apparent whether Board Staff is suggesting the increase in the total OM&A cost would be justified only if there were a corresponding increase in the number of customers. If so, that suggestion would ignore the reality of the significant changes in government policy with respect to green energy that are being implemented, to a very significant degree, through Hydro One. The government's green energy initiatives require a significant restructuring of the distribution system to accommodate new sources of generation. Notwithstanding the cost of these initiatives, the initiatives do not result in an increase in the number of customer's served. Similarly, Hydro One's efforts to address its aging infrastructure result in material increases in costs, notwithstanding the fact that few, if any additional customers will be served. As a result, there is no surprise that Hydro One's costs as measured by these metrics will be increasing.

37. With respect to benchmarking studies, it is almost always the case that a utility that is predominantly serving rural territory (low customer density) would have high cost/customer ratio. As Board Staff indicated, Hydro One is in the

middle of the pack when it comes to cost/circuit Km, a fact which only shows that Hydro One is doing well.

d. Rate impacts will be higher than originally forecast in the application and more weight should be given to the customer satisfaction business value, with an emphasis on rate impacts.

38. As submitted in greater detail under **Issue 1.5**, the PWU is of the view that the impact on customers is unfortunate in that the driving force behind it is the confluence of new government mandated initiatives and the need for an unprecedented level of work required not only to accommodate these initiatives but also to maintain an aging infrastructure. The decision to pursue government initiatives is a political one, and it comes with associated costs. Customers must see the “true costs of the power they consume”.

39. It would be inappropriate to give customers the impression that they can receive the benefits of these initiatives, without bearing their costs. The PWU is of the view that Hydro One’s costs will inevitably be increasing for the foreseeable future. There is never a good time for customers to experience cost increases. The simple fact is that proposed work programs need to be carried out; deferring them will result in the degradation of the system, and the defeat of government policy initiatives, and result in the deferral of the “unacceptable cost impact” from this timeframe to an “unacceptable cost impact” in a future period. Deferring work programs and their associated costs to future periods in order to mitigate near term rate impacts is an easy and popular solution. The deferral of capital and maintenance work rarely has an immediate, measurable negative effect on customer service or reliability. However, the deferral of work is not the responsible solution. The ongoing deferral of needed sustaining capital and maintenance work is like failing to provide timely treatment to an insidious disease. It simply multiplies the problems that the patient will face later. It shifts to future ratepayers the burden of today’s ratepayers having failed in their responsibility to contribute their fair share to maintaining the integrity of the electrical system.

e. Little additional evidence was provided to refute the Mercer report findings on compensation or to show that the $4m reduction for Transmission should not be proportionally applied to Distribution ($9m) (see below).

40. The PWU addresses this issue under **Issue 3.5**, in the ensuing section on Compensation.

f. As shown in the Public Utilities Fortnightly article[21], other jurisdictions have taken into account the economic situation when approving utility operating budgets.

41. In support of its submission that the Board should reduce the revenue requirement sought by the applicant because of the negative effect of the associated rate impact upon customers in the current economic environment, Board Staff relies upon an article filed by it with the Board which was excerpted from a recent edition of Public Utilities Fortnightly. Board Staff submits this article stands as "evidence" of how other regulators in other jurisdictions have responded to the economic downturn.[22]

42. The PWU submits that the Board should be extremely wary of giving Board Staff's submission any weight. It goes without saying that journal articles are not "evidence" of anything.[23] It is not possible to subject a journal article to any testing of any kind, through cross-examination, or otherwise. The Board has not even received copies of the various decisions that are referenced by the article, nor does it have any idea as to whether the underlying decisions are reported and characterized accurately.

43. Moreover, it is far from clear whether the considerations (both legal and factual) at play in the cases discussed in the article are analogous in any way to the situation that the Board must consider in the case of Hydro One's application. There is a very serious question as to whether this Board has the statutory

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[21] EB-2009-0096, Exhibit K4.5

[22] Ibid., Board Staff Submissions, February 1, 2010, Page 5

[23] Other than, presumably, the fact that the article was published.

authority to deny the applicant recovery of costs which are otherwise considered to be prudently incurred, simply on the basis that the consequential rate impact may be considered by some to be unacceptable in light of economic circumstances which are not of the applicant's making.

44. In addition, it is far from clear whether in the U.S. cases referred to, the utilities had, during the course of the preparation of its application, considered the impact of the application on its customers and had made adjustments to its potential work plans, in light of those impacts. This Board had evidence to that effect from Hydro One in the course of this proceeding. In the absence of such information regarding the New York proceeding, this Board can make no assumptions that an "apples to apples" analogy can be drawn to the circumstances of the present case.

45. Finally, it is far from clear whether the relevant rulings of the New York utilities commission have been fully or fairly characterised by Board staff in its submission. In particular, Board Staff while highlighting the "austerity measures" imposed by the commission, fails to note the following excerpt of the article:

> **The PSC was careful to explain, however, that if the cost savings weren't found, the utility could petition for a deferral of the costs and possible recovery in a future rate period.**[24]

46. As a result, it is not at all clear that the New York cases stand for the proposition that the utilities commission imposed disallowances on claimed costs even in cases where economic conditions warranted "austerity". They do not support Board Staff's submission that a disallowance is warranted here.

[24] EB-2009-0096, Exhibit, K4.5, Page 19

g. Lower OM&A expenses "do not necessarily mean that work is not done"

47. In concluding that the Board should reduce the OM&A revenue requirement requested by the applicant, Board Staff makes the following comment:

> **Board staff also emphasizes that lower OM&A expenses do not necessarily mean that work is not done, or that projects cannot be completed. It can also mean that the work can be prioritized more effectively and done more efficiently.[25]**

48. As a general statement, it is difficult to quarrel with this proposition. That said, within the context of this particular case, it is nothing more than an assertion that the proposed reductions in OM&A can be achieved without any negative consequences. Neither Board Staff, nor any other party adduced any evidence whatsoever to identify which work programs could be "prioritized' more "effectively" or could be done "more efficiently". There is no evidence as to how this "efficiency" or "effectiveness" could be achieved, or what dollars would be saved as a result. It is submitted that this Board requires more than homilies as a basis for its decision making; it requires evidence, and none has been offered.

49. In conclusion, contrary to the suggestion of Board Staff, the consequences of not approving the proposed OM&A expenditures to the safety, quality and reliability of service are significant. Specifically, any material disallowance will mean that:

a. It will take longer and will be more expensive to shorten the vegetation management cycle recommended by the Vegetation Benchmarking Study and hence the perpetuation of higher ongoing costs and low performance in service quality indicators such as SAIDI and SAIFI;

b. The deferring of defect correction work, even when necessary or when the risk to reliability or safety of doing so is lower, can result

[25] EB-2009-0096, Board Staff Submissions, February 1, 2010, Page 10

in higher cost of maintenance in later years, because unplanned maintenance is more expensive than planned maintenance and because all input costs will be higher in the future. This is particularly problematic when we consider the backlog of defects that Hydro One has already logged:

> **Currently, Hydro One has 164,445 logged defects in the distribution lines system. In 2010 we are expecting to complete the final phase of the Data Collection effort. The projected number of defects to be identified in 2010 is 39,000. Beyond 2010 the number of new defects identified is expected to reduce as this will be the second cycle of full inspection. Excluding defects to be recorded beyond 2010, and assuming an accomplishment level of 25,000 is maintained beyond 2011, Hydro One Distribution will have addressed the backlog of outstanding defects by 2018.**[26]

c. Significant impact on legislated expenditures and the investments required to address customer needs, safety and reliability (e.g. Vegetation Management, PCB Programs, and Smart Grid expenditures).

II. COMPENSATION

Issue 3.5 Are the 2010/2011 Human Resources related costs (wages, salaries, benefits, incentive payments, labour productivity and pension costs) including employee levels, appropriate? Has Hydro One demonstrated improvements in efficiency and value for dollar associated with its compensations costs?

50. The PWU is aware of the concerns expressed by parties in this and past proceedings in relation to compensation levels at Hydro One. The PWU has consistently submitted that any consideration of compensation levels for Hydro One should consider the Company's overall staffing strategy because the Board's ultimate goal should be to determine the reasonableness of Hydro One's

[26] EB-2009-0096, Exhibit J6.3, Page 1

total labour costs. Hydro One's staffing strategy has been consistent given the challenge that it is facing in hiring and retaining skilled workers in light of the expected retirement of a significant portion of its labour force, the ever increasing work programs and the competition from the rest of the industry for skilled workers. Moreover, the PWU is of the view that Hydro One has undertaken significant initiatives, and conducted otherwise healthy but intense and aggressive negotiations with the unions, all of which have resulted in noticeable efficiency gains.

51. The PWU is of the view that Hydro One's staffing strategy has brought in incremental benefits: the Company is getting more work done at less cost. In addition, given the fact that legacy compensation levels of union members apply to more than 90% of Hydro One's workforce, its focus on achieving overall cost reductions by negotiating increased management flexibility to run the operations, as opposed to wide scale reductions in wages, benefits and pensions is a responsible strategy. It avoids the risk of work stoppage and unhealthy relationships between employees and management which in turn can negatively affect efficiency.

52. The current collective agreements of Hydro One with the PWU and the Society are effective until 2011 and 2013, respectively. The negotiating parties are bound by the agreements. The Board has a responsibility to allow Hydro One to recover its incurred costs based on the evidence before it. The PWU has consistently submitted that denying Hydro One the recovery of its reasonable compensation costs will only result in Hydro One needing to cut some of its work programs. These programs are required for the ongoing reliable and safe operation of a vast portion of Ontario's distribution system and most of Ontario's transmission system. The PWU continues to be of this view.

Should the Board apply its reasons in EB-2008-0272 Transmission Case to the current application?

53. The PWU notes that the Board's decision with respect to compensation levels in the case EB-2008-0272, Hydro One's 2009/10 Transmission rates

application, has been a subject of discussion in the current proceeding. The PWU submits that it would be inappropriate for the Board to apply its reasons in EB-2009-0272 transmission case to the current application.

54. In EB-2008-0272, the Board considered Hydro One's proposed compensation costs and determined that the amounts sought exceeded the level that would be prudent. As a result, the Board disallowed $4m in compensation costs for each of 2009 and 2010.

55. The evidence adduced in the current proceeding is that, if the same methodology was applied in imposing a reduction to the compensation costs claimed in the present case, the corresponding reductions would be $9m in each of the 2010 and 2011 test years. Board Staff has submitted that at least $9m be disallowed, an amount included in the recommended OM&A reduction of $33m. Other than the Board's decision in EB-2008-0272 concerning the Mercer-Wyman Compensation Cost [and Productivity] Benchmarking Study ("Mercer-Wyman Benchmarking Study"), Board Staff offers little evidence to justify its proposed disallowance of $9m in compensation cost. In other instances, Board Staff's reasons are unconvincing. For example, Board Staff states:

> **Under cross examination, it was established that of the 171 employees that left the organization in 2008, 116 were the result of retirements and only 55 were non-retirement terminations. Board staff submits that this is an extremely low rate of turnover.**[27]

56. It is not clear to the PWU how the fact that "only 55 employees" were non-retirement terminations can be a justification for disallowance. Hydro One's position has always been that without competitive compensation, the Company could lose its skilled workers. If the Company's compensation is not competitive, turnover will certainly increase significantly and successful hiring will decline. The relatively low number of employees who have departed is evidence of the success of Hydro One's strategy. In that regard, Board Staff's recommendation

[27] EB-2009-0096, Board Staff Submissions, February 1, 2010, Page 11

that $9m be disallowed would amount to recommending a higher turnover for Hydro One, which is the loss of skilled labour that is in high demand.

57. There are a variety of reasons why the conclusions of the Board in EB-2008-0272 should not be applied in this case. At the outset, however, it is important to recall the background of the Mercer-Wyman Benchmarking Study filed by Hydro One in EB-2008-0272. Apparently, the findings of the Mercer-Wyman Benchmarking Study were considered to be a sufficient basis for the Board's decision.

58. The Mercer-Wyman Benchmarking Study was filed by Hydro One as per the Board's direction in its decision on Hydro One's 2008-2009 transmission rate application, EB-2006-0501, issued on August 16, 2007. The Board directed Hydro One to engage an independent party to submit an independent, testable and repeatable report on compensation cost and *productivity* for Hydro One and comparable companies as part of its next transmission rate application. The Board's direction had specifically stated that the Benchmarking Study should include empirical evidence that reveals the relative *productivity* of Hydro One's workforce in comparison to other utilities.

59. The PWU argued in EB-2008-0272 that compensation levels such as basic salaries and benefits should not be considered in isolation, and the PWU viewed the Board's direction as confirming the point that the Board ought not to be interested only in what a company pays its workers without also evaluating what the company gets in return.

60. As the PWU submitted in EB-2008-0272, the two questions before the Board with respect to these benchmarking studies should have been:

a. Do the studies meet the Board's expectation as stated in EB-2006-0501?

b. If they do, do they conclusively demonstrate that Hydro One's compensation levels are unreasonable?

61. Both the compensation and productivity aspects of the benchmarking study filed by Hydro One in EB-2008-0272 had limitations. Ratepayer groups and the Board in its decision questioned the credibility of the productivity findings of the study which, using four different metrics, put Hydro One's productivity in a generally favourable position, at least as confirmed by most of the indicators, relative to other utilities included in the study. However, what the Board and the intervenors found to be more "convincing" was the conclusion of the benchmarking study that Hydro One's compensation (base salary, bonus, etc) was above market median by 17%. In particular the compensation for the PWU represented employees was found to be the main contributor to the above-median figure.

62. It is clear that the Board, when confronted by the difficulty of accepting the technical analysis and conclusion, particularly of two of the four metrics, ignored the entire productivity consideration. In doing so, it ignored its stated objective of the directive to consider *the* combination of cost and productivity. Instead, the Board considered the relatively non-controversial and easily aggregated numbers relating to salary, pension and bonus and accepted the compensation benchmarking study's conclusion.

63. A number of deficiencies of the compensation benchmarking study, such as the exclusion of outsourcing and overtime policies and other factors such as the disregard of qualification and skill level requirements[28], safety and reliability records, legacy collective agreements, etc. were tolerated by the Board. The PWU submitted that Hydro One's overall labour rates were not unreasonable and the opposite view was not supported by either the benchmarking studies or the existing business, economic and labour market realities.

64. The suggestion by some intervenors in the current proceeding that the Board should simply apply the EB-2008-0272 decision related to the

[28] For example. Hydro One's Regional maintainer classification has additional multi-skills and duties beyond that of a power line maintainer in other LDCs included in the study; see EB-2009-0096, Transcript, Volume 7, Page 46.

benchmarking study in the current case and deny a corresponding amount from the compensation cost for each of the 2010 and 2011 test years gives credibility to a flawed analysis that neglects the fundamental link between compensation levels and productivity which a benchmarking cost efficiency study should address.

65. The Distribution Benchmarking Study[29] conducted for the Board by Pacific Economics Group ("PEG") and accepted by the Board as the basis for determining the productivity stretch factors for the Ontario distributors in the Board's 3rd Generation IRM establishes Hydro One as an average performer relative to the other Ontario distributors in terms of cost efficiency. Given the Board's acceptance of Hydro One as an average cost efficiency performer, it would be inconsistent for the Board to disallow a portion of Hydro One's proposed revenue requirement based solely on the results of a compensation benchmark study, especially one with the shortcomings noted above.

66. Further, the authors of the benchmarking studies filed by Hydro One in EB-2008-0272 indicated that they encountered a number of data-related problems. They also pointed out that labour productivity analyses are not common in the industry because it is *total cost*[30] that is of interest. From the outset, it was also clear that even the most complex analyses of productivity such as Total Factor Productivity suffer from a number of difficulties that result in analytical shortcomings. However, these difficulties should not lead the Board to abandon its consideration of productivity comparisons in its entirety and subjectively determine a dollar amount that might be denied.

67. Furthermore, in no way should such a subjectively determined disallowance then be used as the basis for another arbitrary disallowance in a *subsequent* rate case. The point is that any measurement and comparison of a company's performance and efficiency without due consideration to overall cost

[29] PEG Sensitivity Analysis on Efficiency Ranking and Cohorts for the 2009 Rate Year: Update – December 3, 2008

[30] EB-2008-0272, Exhibit A, Tab 16, Schedule 2, Attachment 1, Page 21

per unit of work will be flawed. If the Board determines that reliable benchmarking studies which compare both compensation levels and productivity are difficult to conduct, the alternative course would be to consider Hydro One's year-over-year productivity improvements. Rather than measuring relative productivity across entities at a single point in time, the Board should focus on the assessment of the relative productivity within a single entity, across different periods of time. Essentially, this is an IR concept within a cost of service application.

68. The PWU submits there are a number of additional reasons why the conclusions of the Board in EB-2008-0272 should not be applied in this case.

69. First, there are good reasons to question the correctness of the Board's decision in EB-2008-0272. In particular, it is submitted, with respect, that the Board's decision on this issue in EB-2008-0272 is both incorrect and lacking in internal logic. Specifically, the Board contrasts labour costs under a collective agreement to the costs of other goods and services acquired by the utility. With respect to other providers of goods and services, the Board notes that there are multiple providers in the marketplace, which are at arm's length to the company and the Board can "rely upon market forces" to determine that the costs incurred are prudent. By contrast, under a collective agreement, there is a single source provider, and the nature of the relationship cannot be considered to be "arm's length" in the same manner as stand alone good and service providers.

70. Moreover, in its Decision on EB-2008-0272, the Board noted the following:

> **The Board's examination cannot include an analysis of the myriad compromises and trade-offs associated with collective bargaining. The subjectivity related to that exercise would render it meaningless if not inoperable.[31]**

71. The gist of the Board's analysis is that ordinary market forces of supply and demand do not apply to collective agreements and, as a result, the Board cannot rely on the existence of those forces to ensure that the costs incurred are

[31] EB-2008-0272, DECISION WITH REASONS, May 28, 2009, Page 29

prudent. This conclusion is inconsistent with the direct evidence adduced both in EB-2008-0272, and in this case, that the laws of supply and demand do apply to the supply of labour, both under collective agreements and otherwise, as well as the evidence that there is presently a demand/supply imbalance whereby the demand for the skilled labour that Hydro One requires exceeds the supply. There was direct evidence that the excess of demand over supply is a North America-wide phenomenon which has the entirely predictable effect of driving up the cost.

72. Moreover, the suggestion that Hydro One and its trade unions do not operate on an "arm's length" basis is both factually and legally incorrect. Contrary to the more "collaborative" systems that exist in other (largely European) jurisdictions the legal structure of labour relations in Ontario has, since the earliest days of the *Labour Relations Act*, institutionalized an adversarial system between employers and trade unions. Indeed, pursuant to s. 15 of the *Labour Relations Act* a trade union cannot be certified by the Labour Relations Board if it does not maintain sufficient independence from the employer.[32]

73. There was direct evidence in this proceeding that the current terms and conditions between Hydro One and the Society of Energy Professionals are based upon the resolution of a 15 week work stoppage. It is difficult to imagine a more "arm's length" or adversarial economic relationship than that.[33]

74. Unfortunately, in reaching its conclusion in EB-2008-0272, the Board undertook the very exercise that it identified as "subjective" and "meaningless". Specifically, the Board concluded that Hydro One's compensation costs under its collective agreements were too high, ignoring the fact that compensation is simply one of the "myriad of compromises and trade-offs associated with collective bargaining". Obviously, the collective agreements between Hydro One

[32] *Labour Relations Act, 1995* S.O. 1995, c. 1, Schedule A, s. 15

[33] EB-2009-0096, Transcript, Volume 8, Pages 59-60

and its trade unions deal with numerous issues concerning the terms and conditions of the affected employees, compensation being but one. Notwithstanding its own warning regarding the pitfalls of an attempt to analyse the implicit trade offs embedded in collective agreements, the Board did exactly that.

75. At the most fundamental level, the Board's conclusion in EB-2008-0272 was erroneous because it incorrectly applied the prudence standard to the issue of compensation levels. In particular, the Board failed to recognize that prudency is an intrinsically relative concept. Implicit in any determination that a course of action was "imprudent" is the conclusion, based upon evidence, that there was another course of action available, that was not followed, which was more prudent.

76. The Board erred because it reached the conclusion that Hydro One's compensation levels were not "prudent" without identifying any means by which a more prudent outcome could be achieved. Implicit in the Board's decision is an assumption that Hydro One's compensation costs could be reduced without any adverse consequences to Hydro One, its system or its customers. Any such assumption is contrary to both the evidence and to logic. Specifically, there was direct evidence before the Board, both in EB-2008-0272 and in this case, that in Hydro One's judgment, no material reductions in wage rates with the PWU could be achieved, if at all, in the absence of a prolonged work stoppage. Moreover, it was Hydro One's uncontested evidence that it would not be able to operate its distribution system in the face of a PWU work stoppage. The simple fact is that an attempt by Hydro One to achieve reductions in wage rates cannot be assumed to be achievable without significant negative consequences to the reliability of the system and its customers, and any consequential impact on the Ontario economy arising therefrom.

77. Hydro One has specifically recognized these costs and considered the prudence of their approach to compensation, relative to the available alternative. The Board must do the same.

78. With respect to the specific evidence in this case, it is submitted that the following points are relevant to the Board's consideration:

a. Hydro One faces significant demographic challenges to its workforce, with large numbers of highly trained staff eligible to leave the Company on pension in coming years;[34]

b. Hydro One is becoming a bigger company with numerous new and additional responsibilities.[35] As a result, not only does Hydro One need to replace departing staff, it must recruit new, incremental staff in significant numbers;

c. The increase in OM&A that Hydro One is seeking in this case is not due to increases in compensation rates, but rather due to the increase in the volume of work that the Company will be performing.[36] The increased size of the work program has caused a need to increase the complement of the workforce, along with every other aspect required to perform the work - increased amount of equipment and materials, increased support costs, increased commodity costs, increased component costs, etc.;

d. Many other North American utilities are in a similar situation, facing both significant departures and significant need for expanded workforces;[37]

e. There is a North America-wide shortage of skilled electrical industry employees relative to demand;[38]

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[34] EB-2009-0096, Exhibit C1, Tab 3, Schedule 1, Page 1, Lines 17-25

[35] Ibid., Page 2, Lines 4-21

[36] EB-2009-0096, Transcript, Volume 5, Page 24, Lines 19-25

[37] Ibid., Exhibit C1, Tab 3, Schedule 1, Page 1, Lines 5-14

[38] Ibid., Transcript, Volume 2, Pages 73-75

f. Hydro One has undertaken a number of initiatives to increase the supply of potential candidates,[39] but these efforts take time and they have not reached full fruition as yet;

g. The demand supply imbalance in the labour market faced by Hydro One and others in the electrical industry also exists in the markets for other inputs, including commodities and electrical components;[40]

h. It is extraordinarily difficult for any employer to engage in "concession bargaining" in circumstances where it is an expanding business and there is a demand/supply imbalance in favour of labour;[41]

i. Relative to the other Ontario Hydro successor companies (dealing with the same bargaining agents) Hydro One has experienced smaller increases in wage rates since 1999;[42]

j. The wage escalations contained in the most recent collective agreements entered into by Hydro One are the same as, or lower than, those prevailing in the market at the time those collective agreements were entered into;[43]

k. Hydro One's various collective agreements with its construction trades are in fact agreements entered into on behalf of Hydro One (and others) by the Electrical Power Systems Construction Association ("EPSCA"), which is an employers' organization representing various contractors in the electrical power sector. This organization is not controlled by Hydro One; it is but one member.

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[39] EB-2009-0096, Exhibit C1, Tab 3, Schedule 1, Pages 4-5

[40] Ibid., Transcript, Volume 4, Pages 71-72

[41] Ibid., Transcript, Volume 8, Page 66, Line 28 & Page 67, Lines 1-14

[42] Ibid., Exhibit C1, Tab 3, Schedule 2, Page 14

[43] Ibid., Exhibit H, Tab 6, Schedule 5, IR #3

Those agreements were considered to be acceptable by the organization as a whole, not just Hydro One. The wage escalation in the EPSCA agreements is the same as contained in the current PWU agreement (3%)[44] which indicates that Hydro One is maintaining wage escalations at competitive levels. The point is that Hydro One has no control over the legacy events that established its base levels of compensation; what it can control is what it does at the time of renewals. The evidence on that front, it is submitted, is that Hydro One has been at or below "the market";

l. For the period 2009-2011, the total Networks (Transmission and Distribution) work program is expected to increase by over 33% whereas the increase in regular staff is expected to increase by only approximately 16%[45]. The significance of this statistic is that Hydro One's resourcing strategy is trending towards a shift away (on a relative basis) from its most "high cost" labour source. The two tables below, for example, show a labour composition trend in which the proportion of PWU represented regular employees and their corresponding total wages is declining over time:

Table 1: Proportion of PWU Regular Staff as % of Hydro One Regular Staff and Total Hydro One Staff[46]

HEAD COUNT

Year	PWU Regular Staff	Total Regular Staff	PWU % of Total Regular Staff	Total Staff	PWU % of Total Staff
2006	2,862	4,018	71.23%	5,301	53.99%
2007	3,084	4,312	71.52%	5,893	52.33%
2008	3,202	4,714	67.93%	6,547	48.91%
2009	3,382	5,185	65.23%	7,456	45.36%
2010	3,754	5,848	64.19%	9,552	39.30%
2011	3,909	6,053	64.58%	10,245	38.16%

[44] Ibid., Transcript, Volume 8, Pages 88-91

[45] EB-2009-0096, Exhibit C1, Tab 3, Schedule 2, Page 9

[46] Derived from EB-2009-0096, Exhibit H, Tab 7, Schedule 67, Attachment 1

Table 2: Proportion of Total Wages for PWU Regular Staff as % of Total Wages for Hydro One Regular Staff and Total Hydro One Staff[47]

TOTAL WAGES ($)

Year	PWU Regular Staff	Total Regular Staff	PWU % of Total Regular Staff	Total Staff	PWU % of Total Staff
2006	262,294,356	386,958,894	67.78%	459,325,376	57.10%
2007	276,571,977	411,390,956	67.23%	495,526,109	55.81%
2008	297,833,419	461,497,554	64.54%	566,116,882	52.61%
2009	320,845,988	523,095,239	61.34%	656,800,000	48.85%
2010	372,678,682	617,050,793	60.40%	849,500,000	43.87%
2011	401,769,014	660,601,932	60.82%	934,100,000	43.01%

m. Evidence has been adduced that one of Hydro One's staffing strategy; in particular, the use of the PWU hiring hall has resulted in savings. For example, a Hiring Hall Lines journeyperson costs approximately 33% less than the regular PWU Lines journeyperson;[48]

n. PEG's Distribution Benchmarking Study[49] establishes Hydro One as average in terms of cost efficiency relative to other distributors in Ontario;

o. The Board's guidelines[50] indicate that the Board adopts the PEG Distribution Benchmarking Study results as the basis for the determination of the 3rd Generation IRM productivity stretch factors;

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[47] Derived from EB-2009-0096, Exhibit H, Tab 7, Schedule 67, Attachment 1

[48] EB-2009-0096, Exhibit H, Tab 1, Schedule 70, Page 1

[49] PEG Sensitivity Analysis on Efficiency Ranking and Cohorts for the 2009 Rate Year: Update – December 3, 2008

[50] EB-2007-0673, Addendum to the Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, January 28, 2009

p. Hydro One's evidence on its cost efficiency measures provided in its application reflects cost efficiency improvements that are at least equal to the productivity stretch factor that it would be subject to under the 3rd Generation IRM[51];

q. Cuts on compensation only result in postponing or cutting work programs potentially costing the company and ratepayers even more in the longer term;

r. Hydro One's salary escalation is reasonable and in many cases it is actually lower than other collective agreements[52]; and

s. More major construction projects expected in the coming years combined with trouble calls happening outside regular business hours will naturally increase overtime payment levels[53]. However, Hydro One's overtime policy is in line with other major comparator utilities[54]. Moreover, cost savings are realized since the same people on payroll will be working the overtime with no incremental cost incurred by way of benefits, pension, etc.

79. In summary, it is submitted that it has not been demonstrated that Hydro One's compensation costs are not prudent. It is submitted that Hydro One's application in this respect should be approved as applied for.

III. VEGETATION MANAGEMENT

Issue 3.2 Is the 2010/2011 Vegetation Management Budget Appropriate?

80. The PWU has concerns with respect to Hydro One's vegetation management accomplishments. These concerns relate primarily to ongoing

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[51] EB-2009-0096, Exhibit A, Tab 16, Schedule 1, Table 1, Page 5

[52] Ibid., Exhibit H, Tab 6, Schedule 5, Page 2

[53] Ibid., Tab 1, Schedule 72

[54] EB-2007-0681, Exhibit A, Tab 15, Schedule 2, Attachment B, Pages 10-12

safety, reliability and quality of service issues. A number of studies that compared service quality indicators such as SAIDI and SAIFI at Hydro One with other utilities have shown that performance at Hydro One is comparatively inferior; in many cases the Company's performance is in the lowest quartile. While some of this lower performance is understandable given the nature of Hydro One's service territory, a significant part is due to the unacceptably long vegetation management cycle. The PWU is of the view that increased spending required to accelerate accomplishments and ultimately shorten the line brush clearing cycle as recommended by the Vegetation Benchmarking Study will go far in improving Hydro One's performance and controlling costs in the long-term.

81. Hydro One has proposed \$133.2m and \$144.6m in vegetation management spending for 2010 and 2011, respectively. The proposed budget for 2010 shows an increase over the \$118.2m expenditure in 2008, but is lower than the 2009 forecast amount of \$136.1m, an amount proposed within the 3rd Generation IRM.

82. The PWU is of the view that the proposed vegetation management spending partially recognizes the pressing need to shorten the cycle for line and brush clearing. Hydro One's evidence indicates that the proposed spending requirements are based on continuing to reduce the vegetation management cycle such that the implementation of a 7-year cycle can begin in 2011. Hydro One has indicated that the proposal follows two years (i.e. 2007 and 2008) of line clearing accomplishments at about an 8-year cycle and that in order to reduce the cycle further will require a 14% increase in expenditures in 2010 and a 24% increase in 2011 in comparison to the 2007 and 2008 period[55].

83. There are two major drivers justifying the need for continuing to reduce the clearing cycle and the associated increase in funding:

a. *Improved system reliability*:

[55] EB-2009-0096, Exhibit C1, Tab 2, Schedule 2, Page 34

As noted in Section 6 of Exhibit A, Tab 4, Schedule 1, tree-related contacts accounted for 57% of SAIDI and 29% of SAIFI between 2005 and 2008 and the negative impact of trees during storm events is especially acute as trees accounted for 77% of SAIDI and 57% of SAIFI during force majeure events. Hydro One's evidence[56] also indicates that when an average feeder with 7 years of growth is cleared, the improvement in reliability during the first year after clearing is:

- *SAIFI – 21% during non-storms and 49% during force majeure events*
- *SAIDI – 21% during non-storms and 54% during force majeure events*

b. *Lower Cost*:

i. A shorter cycle is more cost effective, as more frequent maintenance results in reduced workload on a per kilometre basis and lower unit costs. It has been shown that[57] a 6 to 7-year average clearing cycle (approximately 14,000 Km/year to 16,700 Km/year of clearing) should provide Hydro One with the lowest long term unit costs. At cycles between 6 and 7 years, the potential exists to decrease the tree component of SAIDI and SAIFI by approximately 18%-24% and decrease the annual total costs by up to approximately 15% after full implementation.

ii. A shorter cycle means far less trouble calls for tree-caused outages; major storm events do not have as severe impacts because there is less vegetation-caused damage and in turn the cost of bringing the system back is much lower. Moreover, as counsel for the PWU pointed out, and as confirmed by Hydro One's

[56] EB-2009-0096, Exhibit C1, Tab 2, Schedule 2, Pages 34-35

[57] EB-2007-0681, Exhibit H, Tab 1, Schedule 14, Attachment B, Pages 11 & 18

witness, in cross-examination, in a situation where the system is already aging and fragile, the impact of a major storm in terms of the scope of the damage would be larger and more severe and not only would there be longer outages but the cost of restoring service would be much higher[58].

84. In supporting Hydro One's corporate goal for first quartile service quality performance, the PWU would prefer Hydro One to not only implement the 7-year cycle sooner than 2011 but also to further shorten the cycle to a 6-year cycle, a cycle closer to the average cycle of comparable utilities as established by the Vegetation Benchmarking Study filed by Hydro One in this proceeding. On the other hand, the PWU recognizes the "affordability" factor that the Company has taken into consideration in developing the current proposal. As Hydro One's witness confirmed under cross-examination, there are incremental savings associated with a more aggressive target (shorter cycle) but that there is a need "to balance off the investment and you have to be able to balance the work execution, can you get it done in the time frame, and get the necessary resources?"[59]

85. For all the above reasons, the PWU respectfully submits that the vegetation management as well as Hydro One's proposed budgets for the remaining components of sustaining OM&A are prudent and appropriate.

C. CAPITAL EXPENDITURES AND RATE BASE

I. SUSTATINING CAPITAL

Issue 4.2: Are the amounts proposed for 2010/2011 Capital Expenditures appropriate including the specific Sustaining, Development and Operations categories?

[58] EB-2009-0096, Transcript, Volume 5, Page 45 (Lines 17-28) – Page 46 (Line1)

[59] Ibid., Transcript, Volume 5, Page 39 (Line 28) – Page 40 (Lines 1-4)

86. The scheduled 2010-2011 capital work program in the sustaining area is larger than the 2008-2009 program. Hydro One has proposed a Sustaining Capital budget of $185.8m and $202.5m for 2010 and 2011, respectively, compared to $170.7m and $176.5m in 2008 and 2009. What the Board must recognize in its consideration of this budget is that the contribution to the increased cost in 2010-2011 compared to 2008-2009, is more reflective of an increase in units of work being undertaken, rather than increasing cost for each unit of work.

87. The PWU submits that given the current and proposed levels of work, if Hydro One does not undertake an increased level of sustaining work now and into the future, the system will be left with a population of assets that is too old and in such poor condition that it simply will not be possible to replace those assets quickly enough to avoid catastrophic outcomes in the future. In other words, in order to make change in terms of the level of accomplishments achieved, Hydro One needs to ramp up its work programs.

88. More importantly, of the three categories of Sustaining Capital, the Lines Sustaining Capital category accounts for the lion's share: $168m and $183m for 2010 and 2011, respectively. Within the Lines Sustaining Capital, Hydro One's evidence indicates that the proposed budget for the two categories, in particular, Trouble Call & Storm Damage and Joint Use & Relocations remain flat, in fact, are lower than the 2008 actual spending levels. As seen from the following table, a somewhat modest increase is seen in the category of Asset Replacement:

Table 3
Lines Sustaining Capital
($ Millions)[60]

	Historic			Bridge	Test	
	2006	**2007**	**2008**	**2009**	**2010**	**2011**
Trouble Call & Storm Damage (d)	90.6	51.7	62.0	60.1	59.3	59.2
Joint Use & Relocations (d)	24.0	27.1	31.2	27.5	30.4	30.5
Asset Replacements	47.5	60.0	64.0	74.0	78.3	93.5
Total	**162.1**	**138.8**	**157.2**	**161.6**	**168.0**	**183.1**

89. The PWU notes that the modest increase in the budget for Asset Replacement is primarily attributable to the Company's Wood Structure Replacement program. The 2010 and 2011 spending requirements for this program are $46.4 and $59.0m which represent an increase over historic years, which the Company says is needed to replace a greater number of poles identified as end-of-life in the pole assessment program.

90. The PWU expressed in cross-examination of Hydro One's expert panel, its concern with Hydro One's ability to accomplish its proposed pole replacement program, and hence the sufficiency of the budget allocated to the task, given the demographics of the poles. Hydro One's evidence indicates that the Company has 1.7 million poles, of which about 635,000 (37%) are over 40 years old and about 310,000 (18%) are over 50 years[61]. Hydro One's plan is to replace 7,500 in 2010, an increase of 500 over the 7,000 replaced in 2009. The increase of 500 pole replacements addresses the premature decay in a subset of red pine poles. In 2011, Hydro One states, the proposed funding will permit further increases in replacements to 9,500 to address the red pine pole issue.

91. Given Hydro One's wood pole demographics and the red pine pole issue, the PWU is concerned with the rate of replacement of end-of-life poles proposed

[60] EB-2009-0096, Exhibit D1, Tab 3, Schedule 2, Page 14

[61] EB-2009-0096, Exhibit D1, Tab 2, Schedule 1, Page 16, Figure 4

by the Company. During cross examination, the PWU put to Hydro One's witness that at a rate of 7,500 poles per year, it would take Hydro One about 41 years to replace poles over 50 years old, which means by the time the last of the poles is to be replaced, it would be a 91-year old pole. Hydro One's witness confirmed that this math correctly represents the state of the aging infrastructure. The witness, however, in accepting the state of the aging infrastructure, explained that the Company's pole replacement programs for the test year are based on the Asset Condition Assessment, failure rate and experience.

92. The PWU's concern goes beyond just the test year. While Hydro One identifies a certain percentage of the poles as very poor, poor, etc. based on its experience and applies this as the basis for its action plan for the test years, this does not give the PWU the comfort that future catastrophic failures will be avoided unless poles are replaced at a faster rate. This was conceded by Hydro One's witness:

> **What you're really talking about, to some extent, is the future issues that may be coming at us, the demographics, the aging infrastructure we have, and what we're going to need to deal with in future.**[62]

93. The PWU submits that the magnitude of this problem is such that the discovery of a solution cannot be put to an indefinite date in the future. Indefinite delay will inevitably cause two major problems. First, delay will make the implementation of a solution a practical impossibility – the remaining time available will be inadequate to accomplish the tasks necessary to avoid unacceptably serious declines in safety and reliability of service. Second, future ratepayers will inevitably be burdened with a disproportionate share of these costs. The simple fact is that the obligation of each generation of ratepayers is to ensure that they contribute to the asset base at a sustainable level. The current level of expenditure on pole replacement is manifestly too low to be sustainable.

[62] EB-2009-0096, Transcript, Volume 5, Page 31, Lines 24-28

94. The PWU's submission on Hydro One's pole replacement program is illustrative of all of Hydro One's assets. As described by counsel to the PWU in the hearing, poles are the "poster child" for distribution assets.[63]

95. The PWU therefore notes the need for the Board to consider the potential consequences of reducing funding for not only the already under-funded pole replacement program, but all the proposed sustaining capital programs.

D. GREEN ENERGY PLAN

Issue 9.1 Does Hydro One's Green Energy Plan meet the Board's filing guidelines and the objectives set out in the Green Energy and Green Economy Act, 2009?

96. Hydro One has presented its GEP covering the five year period from 2010 to 2014. The GEP includes the incorporation of renewable energy generation, development of Hydro One Distribution's Smart Grid and promotion of energy conservation.

97. The issue under consideration (Issue 9.1) is concerned with whether or not the GEP plan meets two requirements: the objectives of the GEGEA and the Board's Guidelines for Deemed Conditions of Licence regarding Distribution System Planning (G-2009-0087) ("GEGEA Guidelines") issued June 16, 2009. There is no doubt that Hydro One's GEP responds to the objectives of the GEGEA by virtue of the elements of the plan: the promotion of the use and generation of electricity from renewable energy sources; the facilitation of the implementation of a smart grid in Ontario; and promotion of conservation.

98. With respect to the GEGEA Guidelines, the PWU is of the view that Hydro One's GEP is generally in line with the "Preliminary Planning Guidelines" in particular, in terms of what is expected of a distributor when it files its GEP.

99. On the other hand, there are aspects of the GEGEA Guidelines which may be controversial and open to interpretation, particularly if the GEP is filed as part

[63] Ibid., Transcript, Volume 5, Pages 36-37

of a distributor's cost of service application, as in the current application. For example, the GEGEA Guidelines propose capital and OM&A deferral accounts for renewable generation connection and smart grid development expenditures. The GEGEA Guidelines also indicate that distributors who anticipate substantial expenses related to the qualifying renewable connection or smart grid development investments and activities may apply for a Funding Adder.[64]

100. The PWU does not consider Hydro One's request for recovery from rates in the test years as going beyond the GEGEA Guidelines in this respect because the proposed work programs are planned as necessary and useful during the period under consideration and those costs need to be recovered. That said, Hydro One has indicated that a Funding Adder with a variance account, should that be the Board's preference, is an acceptable option. It is important, however, that the type of account created to track revenues collected through the Funding Adder be a variance account and not a deferral account wherein the Board could defer the examination of prudence to a later time because Hydro One needs assurance that the costs will be recoverable, although potentially on a deferred basis.

101. The other issue that has been raised during the hearing is the level of detail of the GEP filed, particularly as related to expected connection of renewable generation facilities. The PWU submits that this concern is without substance, for two reasons:

a First, Hydro One has an obligation to connect generation facilities and to do the necessary work to undertake the connection of generation facilities. However, Hydro One has little control over where the renewable facilities locate and at least at this point in time it is difficult to know the nature of the specific projects. Hydro One recognizes there is a risk associated with not having a detailed forecast of renewable generation that will connect to its system by

[64] OEB, G-2009-0087: Guidelines: Deemed Conditions of Licence: Distribution System Planning

MW and by location, however, Hydro One has also considered a number of factors in developing its forecasts[65] and the Company has estimated the proportion of applications it expects to receive in different areas of the province to the best of its ability, presumably with input from the Ontario Power Authority. Hydro One cannot delay work until the exact cost and nature of specific projects are known because that would delay the delivery of the Government's objectives related to the GEGEA. Under the circumstances, Hydro One's GEP plan has a level of detail that can reasonably be included at this stage.

b Second, Hydro One has responded to interrogatories, cross examinations, undertakings, etc. that has resulted in a thorough examination of the GEP which in turn has offered the Board with the information it needs to test the prudence of Hydro One's GEP. Moreover, the consideration of a Funding Adder with a variance account would provide some opportunity to test the prudence of investments. The GEGEA Guidelines also require the distributor to file annual status reports on the implementation of approved Distribution System Plans.

102. It should be noted that other than in the calculation of the GEP cost allocation between internal and external funding, where Hydro One has made certain assumptions (see Issue 9.3 below), Hydro One's assumptions are based either on the Board's Distribution System Code (e.g. allocation of cost between generators and distributor) or Ontario Regulation 330/09 (e.g. recovery of cost).

103. Finally, the September 21, 2009 Government Directive to Hydro One[66] not only indicates the urgency and volume of work that Hydro One needs to carry out in response to the GEGEA, but also the flexibility and discretion that Hydro One

[65] EB-2009-0096, Exhibit J3.2, Page 2

[66] EB-2009-0096, Exhibit H, Tab 6, Schedule 5, Attachment 1

has with respect to the specific planning and implementation of the GEP. It should be noted that the distribution-related work contained in the government letter issued September 21, 2009, is captured in the GEP submitted by Hydro One.[67]

104. For all the above reasons, the PWU submits that Hydro One's GEP meets the objectives set out in the GEGEA and the GEGEA Guidelines to the extent that is attainable by the Company at the present time.

Issue 9.3: Is Hydro One's methodology for allocating Green Energy Plan O&M and Capital costs between the OPA (External Funding Mechanism) and Hydro One (Internal Funding) appropriate?

105. On September 25, 2009, the Board launched EB-2009-0349, a policy initiative dealing with Rate Protection and the Determination of Direct Benefits under Ontario Regulation 330/09 and Section 79.1 of the *Ontario Energy Board Act, 1998* ("the Act"). The Board Staff draft discussion paper was issued on December 14, 2009 and parties have filed comments on it. The Board's report stemming from EB-2009-0349 has not been released yet and it has been indicated during this proceeding that the report may be delayed significantly longer than it had first been anticipated[68].

106. On the other hand, Hydro One has filed in the current application its GEP identifying, estimating and proposing the allocation of direct benefits of certain eligible "green energy" investments, "in a manner that Hydro One considers to be consistent with and meets the expectations of the Regulation 330/09 and of Section 79.1 of the Act."[69]

107. The Board has invited parties to comment in their submissions on the appropriateness of Hydro One's methodology used to split the funding of certain

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[67] EB-2009-0096, Exhibit H, Tab 6, Schedule 5, 3(a)

[68] Ibid., Transcript, Volume 11, Page 12, Lines 12-28

[69] Ibid., Hydro One: Proposal for Disposition of Issues 9.3. Allocation of Direct Benefits In Hydro One's Green Energy Plan, January 18, 2010, Page 1

eligible "green energy" investments between internal (Hydro One distribution customers) and external funding by provincial rate payers, and on what other approaches the Board might take to deal with the allocation of costs as the Board's final policy is being awaited.

108. In its response filed on January 18, 2010, Hydro One proposed that the GEP allocations filed by Hydro One be reviewed by the Board as soon as possible and without waiting for the Board's policy resulting from EB-2009-0349. Hydro One states that it is unnecessary to delay the review of its proposal for the 2010 and 2011 allocation of direct benefits for a number of reasons including that[70]:

a. As indicated in the Board Staff discussion paper, there is insufficient evidence to develop a standardized approach at this time;
b. Hydro One's filed proposal is consistent with the "transitional" approach, principles and criteria recommended in the Board Staff paper; and
c. Once a standardized approach is developed, and if it is inconsistent with Hydro One's approved allocation, the Company would, through its next Cost of Service proceeding, adopt the Board's Policy for all future eligible investments.

109. Following Hydro One's proposal, the Board issued a letter on January 20, 2010 indicating that, while it prefers to wait for the Board's Report in EB-2009-0349 prior to hearing issue 9.3., it will hear from Board staff and any interested parties before making a final determination on this matter.

110. The PWU is of the view that, in order to make a decision that results in a course of action that benefits the Board, the Applicant, and intervenors the Board should consider the following:

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[70] EB-2009-0096, Hydro One: Proposal for Disposition of Issues 9.3. Allocation of Direct Benefits In Hydro One's Green Energy Plan, January 18, 2010, Page 1

a. What is the likelihood that the Board could wait for its Final report on allocation of direct benefits and still be able to make a timely decision on this issue given the urgency related to the GEP conveyed in the Directive to Hydro One?

b. What harm is done by reviewing, adjusting as needed, and approving Hydro One's proposed approach?

c. Are there any remedial measures that the Board can take should such harm happen?

111. The PWU is of the view that the Board's decision on this issue should not be one that jeopardizes the approval and implementation of Hydro One's GEP. The PWU is also of the view that Hydro One's experience and expertise in renewable generation connection puts the Company in a good position to assess how direct benefits from certain GEP related investments should be allocated. In other words, the PWU is of the view that there is a high probability that Hydro One's approach will be very close to any Board policy on the issue.

112. Should Hydro One's approach be materially different from the Board's policy, the Board can advise Hydro One to adopt the Board's policy in its next rate application. Alternatively, the Board could direct the adoption of a mechanism that would result in a fair allocation between the two classes (Hydro One customers and those outside Hydro One) including compensatory measures. It is important to appreciate that Hydro One has little or no vested interest in who is paying. In this regard the PWU agrees with Hydro One that:

> **Hydro One notes that the Board's decision in Hydro One's rate case need not bind the Board in developing an approach for EB-2009-0349. The ultimate approach may differ from the approach proposed by Hydro One and/or from the approach that this Panel approves for Hydro One for 2010 and 2011. As long as the risk of advantaging or disadvantaging customers is small and is not skewed in one direction or the other, then there is no reason to be concerned about setting an initial approach which could evolve as more experience on customer benefit is available. Hydro One is convinced that there is no such risk in this case.**[71]

[71] EB-2009-0096, Hydro One: Proposal for Disposition of Issues 9.3. Allocation of Direct Benefits In Hydro One's Green Energy Plan, January 18, 2010, page 3

113. On the other hand, the PWU sees no harm in the Board hearing from parties on the issue. In fact, a review of the issue using Hydro One's proposed approach as a test case would result in a better understanding of the methodology than what would be expected from the Board's report because the details in the levels of analysis in Hydro One's methodology present real world cases. It is unlikely that there will be a report that has a standardized approach, in a short period of time that would be considered just and reasonable by all. This is ultimately a question of whether a certain group of customers or groups should pay or not and to what extent each would pay. The hearing schedule, however, should be one that is reasonable to permit the submission of parties as well as the rendering of the Board's decision on this application, including the GEP, in a timely fashion. In the PWU's view, such time is one week after Hydro One's reply argument has been filed. It would be inappropriate to presume that a more reasonable and standardized approach would be available anytime soon and/or to delay a decision on the current application.

E. CONCLUSION

114. The fundamental question that the Board should ask in considering the current application is whether it has the mandate and if so, reason to address a socio-economic policy issue that is a global phenomenon and go beyond its responsibility of ensuring rates are just and reasonable using the traditional tools that it uses in reviewing rate applications for prudence. Using these traditional tools, the Board has always denied proposed budgets whenever it determined that the applicant has failed to:

a. Demonstrate the use and usefulness of a capital project;
b. Justify a project's cost through evaluation of alternative projects;
c. Demonstrate proposed work programs are consistent with and necessitated by Government policy, directives, Board rules, regulations and guidelines; and

d. Base its proposed costs on reasonable assumptions, publicly available data and information; and rigorous analysis and planning etc.

115. In other cases where projects are prudent but the rate impact could be significant on rate payers, the Board has traditionally applied mechanisms such as the use of deferral and variance accounts to smooth out rates in a manner that is not detrimental to the cash flow and revenue sufficiency of the utilities.

116. The PWU submits that Hydro One is not denying that the current economic environment is worse than a few years ago and, at least in general terms, that customers are facing difficult times. It is not surprising that the rate impact of the proposed revenue requirement is a major concern for rate payers and their representatives participating in this proceeding. Similarly, there is no doubt that the present economic environment poses challenges to the Board in that it has competing objectives related to its mandate of promoting government environmental initiatives and must approve related projects while considering the rate impact of such approvals on rate payers.

117. The PWU submits that the regulatory tools described above are still appropriate tools within the Board's new mandate. The current economic environment puts pressure on the Board to be even more vigilant in its scrutiny of cost prudence. This does not however mean that addressing the rate impact of a proposed revenue requirement should be the overriding objective. In fact, as indicated earlier, rate payers of the province are moving towards an even more expensive electricity environment in the years ahead because of government policy that is beyond the control of Hydro One and the Board. This situation has completely altered the traditional purpose and meaning of rate smoothing. Any attempt to deny funding in part or in whole to proposed work programs on the basis that "these are difficult economic times" would: put current costs off to the future resulting in higher future rate impacts; allow infrastructure to deteriorate and increase costs of maintenance and replacement in the future; and slow down the implementation of government policy.

118. As a result, the Board should approve the application based on the evidence before it and on the merits of each and specific work program proposed.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

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