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February 5, 2010

VIA E-MAIL

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

Dear Ms. Walli:

Re: Hydro One Networks Inc. – 2010 & 2011 Distribution Rate Application
Board File: EB-2009-0096)

Please find enclosed the submissions of VECC in the above noted proceeding.

Yours truly,

Michael Buonaguro
Counsel for VECC
Encl.

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.

ARGUMENT OF THE VULNERABLE ENERGY CONSUMERS COALITION ("VECC")

February 5, 2010

INTRODUCTION

This is the Final Argument of the Vulnerable Energy Consumers' Coalition ("VECC") in the Hydro One Networks Inc. Application for 2010 and 2011 Distribution rates, EB-2009-0096. It is organized in the same manner as the issues list, with numbering and sub-numbering that matches the issues list numbering scheme. In cases where VECC has specific submissions on an issue, the proposed relief is described within the submission for that issue.

VECC has had the opportunity to review and adopts the submissions of CME with respect to the unacceptably high total bill increases facing consumers over the next several years. In the context of the multiple increases facing ratepayers VECC submits that is incumbent upon the Board to review Hydro One Networks application with a view to managing the rate impacts to within reasonable levels.

VECC's primary submission as to how the Board can mitigate the rate impacts sought by the application relates to the total OM&A and Capital spending proposed by Hydro One Networks, and the degree to which that total spending can be reduced in two ways:

a) The Board should require Hydro One Networks to adjust the underlying costing information used by Hydro One to develop the total cost of its proposed OM&A and Capital spending. Covered under issues 1.2, 3.1, 3.3, 3.5, 4.2, VECC proposes that the total cost of Hydro One Network's proposed Capital and total OM&A (including Shared Services and Other OM&A) spending be reduced. In the area of Total OM&A, VECC submits that a reduction of $20.4M in 2010 and $18M in 2011 are warranted pursuant to our argument under issues 3.1, 3.3 and 3.5. With respect to Capital spending, VECC is unable to calculate the impact of the adjusted assumptions as detailed under our argument in issue 4.2, but submits that the Board can require Hydro One to make such adjustments.

b) Additionally, the Board should require Hydro One Networks to reduce the scope of the proposed Capital and Total OM&A workplans, providing for a level of spending closer to Minimum Level spending. As detailed under issue 4.6, VECC submits that a 10% reduction to the adjusted 2010 Total OM&A and Capital spending workplans and a 5% reduction to the adjusted 2011 Total OM&A and Capital spending workplans will provide Hydro One Networks with an envelope in both categories that are near Minimum Level spending in 2010, building up towards their requested level of spending in 2011. In the case of Total OM&A, this submission requests an additional reduction of $51.73M in 2010 and 26.92M in 2011. In the case of Capital spending VECC cannot calculate the adjusted Capital spending as explained above but submits that reductions to the adjusted Capital spending of 10% in 2010 and 5% in 2011 should be applied by Hydro One Networks.

1. GENERAL

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

Hydro One Networks' Position

In Exhibit A, Tab 18, Schedule 1 Hydro One Networks lists the various Board directives applicable to its Distribution business as a result of previous Board Decisions. In the same Exhibit, Hydro One Networks takes the position that it has responded to all Board directives and undertakings.

VECC's Submissions

Where applicable, VECC has addressed Hydro One Networks' responses to previous Board directions under the appropriate topic in the Issues List.

1.2 Are Hydro One's economic and business planning assumptions for 2010/2011 appropriate?

Hydro One Networks' Position

Hydro One Networks' economic and business planning assumptions are set out in Exhibit A, Tab 14, Schedule 3 and also in Exhibit A, Tab 14, Schedule 1, Appendix A. The assumptions are based on a variety of sources published over the period from late 2008 to April 2009[1]. Hydro One Networks indicated both in response to interrogatories and during the oral hearing that it did not plan on updating its Distribution rate filing for changes in planning assumptions other for the cost of capital[2].

VECC's Submissions

VECC notes that Hydro One Networks' planning assumptions are based on forecasts that in some cases such as Global Insight's Long Term Forecast and Analysis[3], are more than a year old. VECC recognizes that this is due to the need to have such inputs at the start of the planning process and that the initial Application itself was filed over six month ago. However, more recent forecasts show significantly lower escalation rates for distribution OM&A and capital costs. Forecasted borrowing costs are now lower for long term debt but marginally higher for shorter term debt. This can be seen from the following chart.

[1] Exhibit A, Tab 14, Schedule 1, Appendix A, pages 1-2 and Exhibit H, Tab 7, Schedule 16
[2] Exhibit H, Tab 3, Schedule 1 c) and Tr. Vol. 3, pages 103 - 105
[3] Exhibit A, Tab 14, Schedule 1, Appendix A, page 1

	2009	2010	2011
Distribution Costs – Construction Escalation - Application - Update	1.8% 0.9%	1.3% -0.1%	1.3% 1.4%
Distribution Costs – OM&A Escalation - Application - Update	2.7% -2.3%	-0.1% +0.1%	1.0% 2.3%
CPI – Annual Escalation - Application - Update	1.0% 0.9%	2.0% 1.7%	2.0% 2.0%
HON 30 Year Debt Rate - Application - Update	5.86% 5.54%	6.16% 5.84%	7.46% 6.34%
HON 5 Year Debt Rate - Application - Update	3.48% 3,56%	3.78% 3.86%	5.08% 4.36%

Sources: Application – Exhibit A/Tab/Schedule 3, pages 2-4
Update – Exhibit H/Tab 3/Schedules 1 and 27

Hydro One Networks has also updated its 2009 average cost of debt to reflect the actual debt issues placed during the year[4].

VECC submits that there are three issues the Board needs to address with respect to Hydro One Networks' planning assumptions:

- Should the bridge year (i.e., 2009) be updated to reflect actual costs where they are available and will directly impact the test year's costs?
- Should the 2010 and 2011 cost of capital parameters not automatically adjusted through the Board's Guidelines be updated for more recent forecasts?
- Should the other economic assumptions regarding cost escalation, etc. be updated for more recent forecasts?

[4] Exhibit H,Tab 3, Schedule 29

a) Bridge Year Costs

VECC submits, as a matter of principle, Hydro One Networks' weighted cost of debt (as used to determine its 2010 and 2011 cost of capital) should be updated to reflect the actual debt issues placed in 2009. The objective when setting rates on a cost of service basis is to use the best and most reliable information available. In this case, the actual debt issues and resulting costs for 2009 are clearly more reliable than any forecast for purposes of determining the cost of debt for 2010 and 2011. VECC notes that the impact is estimated to be a reduction in the annual revenue requirement of $1.2 M for 2010 and $1.1 M for 2011[5].

b) Forecast Debt Rates

VECC submits that Hydro One Networks' average cost of long-term debt should be revised to reflect the updated interest rate forecast provided in Exhibit H/Tab 3/Schedule 27. The Board bases the costs for the other cost of capital components (i.e. equity and short-term debt) on updated forecasts and there is no reason why, to the extent feasible, the same approach should not be taken for the cost of long-term debt. In VECC's view it is inappropriate to do half an update in this area. If Hydro One Networks' wants to retain it original forecast regarding the cost of long-term debt, VECC submits it should be expected to also retain its original forecast cost of equity.

c) Other Economic Assumptions

VECC notes that there has been a material change in the escalation rates applicable to distribution costs. In the case of OM&A the cumulative difference is over 3% by 2011 and over 2% in the case of capital spending. VECC submits that the differences are material and need to be accounted for, particularly in view of Hydro One Networks' proposed spending and the rate increases customers are facing. VECC also notes that in its decisions for other

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[5] Exhibit J4.6

distributors[6] the Board has required the Applicant to revise its revenue requirement in order to reflect more recent expectations regarding inflation. VECC acknowledges that it may be impractical to expect Hydro One Networks to "re-work" its revenue requirement in order to reflect different assumptions regarding cost escalation in its final rate order. As an alternative, VECC submits that the Board should explicitly take the change in escalation rates into account when making its findings as to the reasonableness of Hydro One Networks proposed levels of OM&A and Capital Spending for 2010 and 2011. This is discussed further under Issues 3.1 and 4.2.

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

Hydro One Networks' Position

Hydro One Networks' evidence states that it has met or exceeded all of the Board's service quality indicators[7]. In the case of service reliability indicators, Hydro One Networks' evidence indicates that it has met the Board's minimum target in each of the last three years with the exception of SAIFI for 2007[8]. Hydro One Networks explains that in 2007 there were several storms that, while not large enough to be excluded as force majeure events, cumulatively had a significant impact on the 2007 SAIFI results[9].

VECC's Submissions

VECC has no specific submissions on this issue.

[6] EB-2008-0226, page 12 and EB-2008-0233, page 12
[7] Exhibit A.Tab 15/Schedule 1, page 7
[8] Exhibit A/Tab 15/Schedule 1, page 8
[9] Exhibit A/Tab 15/Schedule 1, page 9

1.4 <u>Is Hydro One's proposal to change the effective date for implementation of its proposed distribution rates to January 1, 2010 rather than the conventional May 1st effective date appropriate and has Hydro One appropriately addressed the revenue consequences of proposed change?</u>

Hydro One Networks Position

Hydro One Networks states[10] that the primary driver for earlier implementation date is that it will facilitate the incorporation of the new Hydro One Sub-Transmission (ST) rates by other LDCs into their own rates that would usually take effect on May 1st.

VECC's Submissions

VECC submits that the rationale put forward by Hydro One Networks as to the "main driver" for the change is not at all compelling. For those LDCs with Sub-Transmission charges from Hydro One Networks, the costs are a "pass through" and differences between the amounts paid to Hydro One Networks and recovered from customers are recorded in a variance account for subsequent disposition. Therefore, other LDCs are not exposed to any financial risk as result of having to set their LV rate adders in advance of knowing Hydro One Networks' actual rate for a given year. Furthermore, some of these LDCs are also seeking January 1 dates for their rate changes which would tend to frustrate Hydro One Networks' stated objective[11].

In addition, VECC notes that the OEB has recently initiated a consultation regarding the Alignment of Rate Year with Fiscal Year for Electricity Distributors (EB-2009-0423). Accordingly, VECC submits that this issue is being dealt with on a generic basis and the Board should not make a separate finding for Hydro One Networks for either 2010 or 2011.

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[10] Exhibit H/Tab 1/Schedule 6 and Tr. Vol. 3, page 168
[11] Tr. Vol. 3, page 169

1.5 <u>Is the overall increase in 2010 and 2011 revenue requirement reasonable given the impact on consumers?</u>

See VECC's submissions regarding Issue 7.4.

2. LOAD and REVENUE FORECAST

2.1 <u>Is the load forecast and methodology appropriate and have the impacts of Conservation and Demand Management initiatives been suitably reflected?</u>

Hydro One Networks' Position

Various modeling/forecasting techniques are used to develop Hydro One Networks' Distribution load forecast[12]. In addition, specific adjustments are made to the forecast to account for CDM[13]. For the years 2008 through 2011, the reductions in its load attributable to CDM are assumed to be 771 GWh, 1,072 GWh, 2,360 GWh and 2,853 GWh respectively[14]. These values are based on the Ontario Government's 2007 CDM target of 1350 MW and the incremental CDM forecast in the OPA's August 2007 IPSP for the years following[15].

In its original Application Hydro One Networks indicated that a consulting study responding to the Board's EB-2007-0681 directive for a detailed proposal on the incorporation of CDM into its load forecast would be available in September 2009[16]. However, during the interrogatory process Hydro One Networks indicated that the study had been delayed[17] but would be filed when available.

[12] Exhibit A/Tab 14/Schedule 4, page 11
[13] Exhibit A, Tab 14, Schedule 4, page 19
[14] Exhibit A, Tab14, Schedule 4, page 19, Table 4
[15] Exhibit A, Tab 14, Schedule 4, page 8
[16] Exhibit A/Tab 14/Schedule 4, page 4
[17] Exhibit H/Tab 1/Schedule 11

VECC's Submissions

a) Outstanding Board Directive

As of the completion of the oral phase of the proceeding Hydro One Networks had still not filed its proposal as to how to incorporate the impacts of CDM into its load forecast. VECC is concerned with the continuing delay and submits that the Board should direct the Company to file the completed study by June 30th, 2010. In VECC's view, June 30th is a reasonable date for Hydro One Networks to meet given the history of this issue. Also, requiring production of the Study prior to Hydro One Networks' next Distribution rate application would ensure that issue is not further delayed. Finally, the treatment of CDM in load forecasts is an issue that many distributors are dealing with and Hydro One Networks' study could have wider value if produced earlier than its next filing date.

b) CDM in Current Load Forecast

The annual values for CDM incorporated in Hydro One Networks' load forecast exhibit a somewhat unusual pattern, as the savings increase from an annual value of 169 GWh in 2009 to 724 GWh in 2010 but then fall off to 279 GWh in 2011[18]. Hydro One Networks has suggested that the level of CDM it is forecasting for 2010 and 2011 is reasonable because:

- Savings to date (i.e., to 2008) have likely been greater than forecast[19], and
- There are new activities in 2010 that help account for the sharp increase in annual savings[20].

However, when questioned about the historical savings reported Hydro One Networks acknowledged that the results were not of "EMV quality"[21] and, indeed, this is one of the reasons why the Company has been unwilling to propose an

[18] Exhibit H/Tab 7/Schedule 31 and Tr. Vol 1, page 183
[19] Tr. Vol. #9, pages 51 - 52
[20] Tr Vol #9, page 46
[21] Tr. Vol #9, page 52

LRAM[22]. The Company also acknowledged that its estimates of CDM savings are based on the assumptions available at the time and were not revised to reflect new, and in some cases significantly lower[23], savings assumptions recently issued by the OPA[24]. During cross examination, Hydro One Networks' witnesses offered some possible reasons for the changes in these assumptions. However, it's clear that these were speculative as they ultimately indicated that one would have to refer to the OPA to understand the basis for the changes[25].

Turning to the 2010 savings, VECC submits that it is highly unlikely TOU rates and new codes will yield the significant savings Hydro One Networks claims[26]. The introduction of TOU rates is just starting and it is hard to see how this will have a big impact in 2010. Similarly, codes and standards primarily impact only when electricity-using "stock" turns over and/or new stock is acquired. Also, even in terms of the OPA programs delivered by Hydro One Networks, some of the more successful 2008 programs, such as the Double Return, were not carried over to 2009[27].

Overall, VECC submits that the evidence does not conclusively support either the claim by Hydro One Networks regarding the CDM achieved to-date or the claim that the increased CDM for 2010 will occur.

c) 2010 and 2011 Load Forecast

While VECC has concerns about the CDM estimates Hydro One Networks has included in its load forecast, VECC also notes that the economic assumptions underlying the forecast are optimistic relative to more recent updates. For example, the Ontario GDP forecast from April 2009 used by Hydro One Networks assumed a decline of 2.5% in 2009 followed by growth of 2.3% in 2010 and 3.5%

[22] Tr Vol #9, page 43
[23] Tr Vol 10, page 11 – savings for 15 watt CFLS changed from 104 kWh to 43 kWh
[24] Tr Vol 10, page 12-13
[25] Tr Vol 10, pages 14-15
[26] Tr Vol 9, page 59
[27] Tr Vol 10, pages 9-10

in 2011[28]. However, more recent forecasts suggest that Ontario GDP will be lower in all three years relative to that forecast in April 2009[29].

Overall, VECC submits that Hydro One Networks' load forecast should be accepted for rate setting purposes, as filed. This submission is not based on the view that the current load forecast represents the best estimate of likely loads in 2009 and 2010. Rather it reflects the fact that while the change in economic conditions may suggest that forecast should be lowered, VECC has ongoing reservations that Hydro One Networks' forecast may overstate the impact of conservation and demand management programs.

2.2 Is the proposed amount for 2010/2011 external revenues, including the methodology used to cost and price these services, appropriate?

VECC has no submissions on this issue.

3. OPERATIONS, MAINTENANCE and ADMINISTATION COSTS

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

Hydro One Networks' Position

Hydro One Networks' proposed level of total spending on Sustaining, Development, Operations and Customer Care is $463.2 M in 2010 and $482.4 M in 2011[30]. This compares with an actual 2008 spending of $404.7 M.

[28] Exhibit A/Tab 14/Schedule 4, page 6
[29] Exhibit H/Tab 1/Schedule 12
[30] Exhibit C1/Tab 2/Schedule 1, page 2

VECC's Submissions

a) Key Drivers

The majority of the increase (i.e., $56 M out of $77.7 M for 2011) is due to increased Sustaining OM&A expenditures from $284.5 M to $340.5 M[31]. Key drivers of the increase in this area are:

- Vegetation Management - $26.4 M[32]
- Station PCB Management - $ 5.6 M[33]
- Line PCB Management - $10.8 M[34]
- Smart Meters - $ 6.9 M[35]

The increase in Development OM&A over this period is $13.9 M with virtually all of it attributable to Hydro One Networks' GEP[36].

Operations OM&A increases by $5.2 M, with the increase being largely attributed to smart grid, smart meter and generation connections[37].

Customer Care costs increase by $2.6 M, again largely attributable to the GEP[38].

b) Inflation

From 2008 and 2010, the cumulative difference in the inflation rate for distribution OM&A costs (i.e., over 2009 and 2010) between the rates used in the Application (1.027*0.999=1.026 or 2.6%) and those based on the Updated forecast (0.977*1.001=0.978 or -2.2%) is -4.7%[39]. For 2011, the cumulative difference is -3.5%[40].

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[31] Exhibit C1/Tab 2/Schedule 2, page 3
[32] Exhibit C1/Tab 2/Schedule 2,page 3
[33] Exhibit C1/Tab 2/Schedule 2, page 9
[34] Exhibit C1/Tab 2/Schedule 2, page 22
[35] Exhibit C1/Tab 2/Schedule 2, page 28
[36] Exhibit A/Tab 14/Schedule 2, page 1
[37] Exhibit C1/Tab 2/Schedule 4, page 8 and Tr Vol. 5, page 81
[38] Exhibit C1/Tab 2/Schedule 5, page 3 and Tr Vol 5, page 82
[39] 0.978/1.026
[40] =(0.977*1.001*1.023)/(1.027*0.999*1.01)

In response to a VECC Interrogatory, Hydro One Networks indicated that the total wages attributable to Distribution were roughly $492.7 M for 2010 and $541.8 M for 2011[41]. Using the same approach[42] (i.e., the allocation of Corporate Pension costs as set out in Exhibit C1/Tab 3/Schedule 2, Appendix A, page 2), the split of Distribution wages between OM&A vs. Capital is calculated to be 56.45% vs. 43.55% for 2010 and 56.92% vs. 43.08% for 2011. Applying these percentages yields values for total distribution wages charged to OM&A of $278.1 M in 2010 and $308.4 M in 2011. Based on the total OM&A costs forecast for 2010 and 2011[43], this suggests that non-wage OM&A is approximately $277.2 M in 2010 and $261.8 M in 2011. After allowing for pensions costs[44] and other benefits, non-labour OM&A for each year will still likely exceed $200 M. Applying the cumulative impact of the updated escalation factors for Distribution OM&A to this value would suggest that 2010 OM&A is overstated by at least $9.4 M and that 2011 OM&A is overstated by at least $7.0 M.

As discussed under Issue 1.2, VECC submits that the Board should adjust Hydro One Networks' allowed OM&A for 2010 and 2011 to account for these differences in cost escalation for non-wage related OM&A.

To be clear, it is VECC's position that these reductions reflect the observation that Hydro One Networks' evidence overstates the cost of its non-labour related OM&A. As discussed later on under Issue 4.6, VECC also submits that the scope of the work is too large given the overall rate impacts face by ratepayers, such that planned work should be reduced to be more in line with Minimum Level spending.

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[41] Exhibit H/Tab 7/Schedule 68, part c)
[42] Exhibit H/Tab 7/Schedule 68, part b)
[43] Exhibit C1/Tab 2/Schedule 1, page 2 – 2010: $560 M less taxes of $4.7 M and 2011 - $575.2 M less taxes of $4.8 M
[44] Exhibit C1/Tab 3/Schedule 2, Appendix A, page 2

c) PST/GST Harmonization

Hydro One Networks' Position

Hydro One Networks does not track the PST relating to OM&A expenditures. However, Hydro One Networks has indicated that a process will be developed to track the PST savings in OM&A costs after July 1, 2010 that result from the PST/GST Harmonization. It has indicated that the estimated savings will be tracked in Deferral Account 1592[45].

VECC's Submissions

VECC finds it unfortunate that Hydro One Networks can not estimate the PST related to its 2010 OM&A expenditures. However, given this circumstance VECC agrees that a Deferral Account should be established to track the savings that arise post-July 1st, 2010.

3.2 <u>Is the 2010/2011 vegetation management budget appropriate?</u>

Hydro One Networks' Position

The proposed increased levels of spending on vegetation management are designed to achieve a 7-year cycle by 2011[46]. The vegetation benchmarking study undertaken for Hydro One Networks concluded that the Company's efficiency was better than average when measured in terms of labour hours per kilometer but worse than average when measured in term of cost per kilometer[47]. The same result held when utilities were benchmarked on a per tree treated basis in that Hydro One Networks was better than average in term of hours per tree but worse in terms of cost per tree[48].

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45 Exhibit H/Tab 3/Schedule 12
46 Exhibit C1/Tab 2/Schedule 2, page 34
47 Exhibit A/Tab 15/Schedule 2, page 2
48 Exhibit A/Tab 15/Schedule 2, page 3

VECC's Submissions

a) Proposed Spending and Vegetation Cycle

In its 2008 Rate Application Hydro One Networks proposed moving from a 10-11 year vegetation cycle to an eight-year cycle[49]. By 2009, Hydro One Networks was one quarter of the way into implementing an eight-year cycle and is now proposing to move to seven years[50]. VECC also notes that while the spending in most of Hydro One Networks' program areas is at Level 1 or Level 2[51] above the Minimum Spending level, for Vegetation Management the proposed spending for 2011 represents a Level 3 accomplishment[52]. Indeed, it appears the only difference between the proposed level spending and one based strictly on asset need is that Hydro Networks is not moving immediately to somewhere between a six and seven year cycle[53].

VECC acknowledges that there may be long term benefits in moving to a seven year cycle. However, given the unique circumstances of 2010 where customer affordability will be challenged not only by Hydro One Networks' increasing programs costs for matters such its GEP and PCB management but also by the introduction of the retail sales tax on electricity bills and the Board's new cost of capital formula with a higher ROE, VECC submits that now is not the time to be moving vegetation management spending to a level almost commensurate with what planners' consider to be ideal in an unconstrained world. In VECC's view, a more appropriate plan would be to maintain the vegetation spending level at the eight year cycle for at least 2010. VECC notes that even this level of spending will produce reliability improvements over historic levels as Hydro One has not fully implemented the eight year cycle.

[49] EB-2007-0681 Decision, page 12
[50] Exhibit C1/Tab 2/Schedule 2, page 35
[51] Tr. Vol. #3, page 132
[52] Tr. Vol #6, page 97
[53] Tr Vol #6, page 98

b) Vegetation Benchmarking and Efficiency

In discussing the various benchmarks used in the CN Utility Consulting Study, Hydro One Networks notes the consultant's conclusion that hours per kilometer is a more reliable efficiency measure than cost per kilometer[54]. Indeed, CN Utilities notes that in discussions with Hydro One Networks it was clear that the focus of the company was on labour hours per kilometer and ways to improve (reduce) it. To this end, the example of mini-grinders was cited as a way of substituting equipment for labour.[55].

VECC submits that Hydro One Networks' focus on labour hours is misdirected. The concern of intervenors in EB-2007-0681 was the overall cost of the vegetation management program. Similarly, in its EB-2007-0681 Decision[56] the focus of the Board's directive regarding benchmarking was costs and the comparison of costs across utilities. Focusing strictly on labour, as Hydro One Networks apparently does, can lead to the adoption of expensive equipment-based approaches to vegetation management that reduce labour hours but increase costs overall.

Given this lack of focus on "costs" VECC submits that Hydro One Networks should be able to more effectively deploy its budgeted vegetation management dollars and achieve greater results in terms of kilometers managed and trees treated. As result, the reduction in 2010 vegetation management spending recommended above should be able to reduce the vegetation management cycle to less than eight years.

[54] Exhibit H/Tab 1/Schedule 159
[55] Exhibit A/Tab 15/Schedule 2, Attachment 1, page 17
[56] Page 12

3.3 Is the proposed level of 2010/2011 Shared Services and Other O&M spending appropriate?

Hydro One Networks' Position

The core areas for shared services are Common Corporate Functions and Services, Asset Management and Information Technology. Overall, the total cost for these three areas is increasing from $134.3 M in 2008 to $184.9 M in 2010 and $201.0 M in 2011[57]. These various shared services activities support the delivery of Hydro One Networks' overall work program and grow as the program requirements increase.

VECC's Submissions

VECC notes that there have been significant increases in the total spending in these areas. VECC acknowledges that higher spending is required to support the larger work program, driven in no small part by the new requirements under the GEGE Act. However, a review of the filed materials regarding the results[58] of the prioritization process used in business planning indicates that Asset Management and Common Corporate Functions and Services (CCFS) do not appear to go through the same level of challenge and scrutiny as other aspects of Company's OM&A budget (e.g., there is no Minimum Spend level reported for these areas). Furthermore, as VECC's Counsel demonstrated during cross-examination[59], there have been significant increases in the 2010 costs for these areas between the transmission filing (EB-2008-0272) and the current application over and above what can be attributed to the GEGE Act. Indeed, for Asset Management the increase was $11.9 M on an adjusted 2010 base of $125.8 M, where only $6.2 M is attributable to the GEGE Act[60]. In the case of CCFS the increase is $13.4 M on an adjusted base of $89.6[61], where only $2 M is

[57] Exhibit C1/Tab 2/Schedule 6, page 3. Note: The values quoted include capitalized overheads.
[58] Exhibit H/Tab 7/Schedule 39
[59] Tr Vol #8, pages 12-22
[60] Tr. Vol #8. pages 12-14
[61] Tr Vol #8, page 19

attributable to the GEGE Act[62]. When asked to explain the additional increases in areas such as Asset Management, Hydro One Networks response was simply that this was a new business plan with new information[63]. In VECC's submission such explanations are inadequate for Board, should also be inadequate for Hydro One Networks' management and a modest reduction (e.g., $2 M) in OM&A for these areas is warranted[64].

3.4 <u>Are the methodologies used to allocate Shared Services and Other O&M costs to the distribution business and determine the distribution overhead capitalization rate for 2010/2011 appropriate?</u>

VECC has no submissions regarding these two matters.

3.5 <u>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 compensation costs?</u>

Hydro One Networks' Position

Hydro One Networks refers to the compensation and productivity benchmarking study filed in the recent transmission case, but suggests that the results must be applied with caution.[65] It points out that its wage increases have been less than those of Ontario Hydro's other successor companies[66]. Finally, Hydro One Networks notes that while its work program is going up by 33% over the 2009-2011 period, its regular staff increase is expected to increase by approximately 16%[67].

[62] Tr Vol #7, page 20
[63] Tr Vol #8, pages 16-17
[64] $2 M is approximately 25% of the increase in these two areas not attributed to the GEGE Act.
[65] Exhibit C1/Tab 3/'Scheduele 2, page 10
[66] Exhibit C1/Tab 3/Schedule 2, pages 13-17
[67] Exhibit C1/Tab 3/Schedule 2, page 9

VECC's Submissions

In EB-2008-0272 (Hydro One Networks' Transmission Revenue Requirement Application: 2010-2011), Hydro One Networks responded to an earlier directive from the OEB and filed a "Compensation Benchmarking Report" prepared by Mercer/Oliver Wyman. On the basis of this report and evidenced adduced during the proceeding, the Board's Decision stated[68]:

> The Board concludes that it is appropriate to disallow some compensation costs because these costs are substantially above those of other comparable companies and the company has failed to demonstrate that productivity levels offset this situation. But while the Board does not consider the productivity portion of the Mercer Study to be of determinative value in support of the application it does not draw any negative conclusions from the study either.

Furthermore, on the basis of this finding the Board went on and concluded[69]:

> The Board has already indicated that while the full level of compensation has not been justified, Hydro One has made strides in controlling these costs. The Board will disallow $4 million in each of the test years; this level of adjustment goes some way toward aligning Hydro One's costs with other comparable companies.

Hydro One Networks has indicated[70] that the equivalent reduction in OM&A for its Distribution business would be $ 9 M. However, it suggests that Board should be cautious in extending the reduction to Distribution OM&A based on the new information it has provided regarding its wages relative to those of the other Ontario Hydro successor companies[71]. VECC disagrees.

First, in reaching its EB-2008-0272 Decision the Board was aware of the lower annual increases per employee that had occurred in recent history[72]. Second, with respect to benchmarking against successor companies, the arguments that Hydro One Networks is now putting forward are not new. They are precisely the same ones that the PWU made to the Board in its final submissions for EB-2008-

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[68] EB-2008-0272 Decision, page 30
[69] EB-2008-0272 Decision, page 31
[70] Exhibit H/Tab 10/Schedule 40, part iv)
[71] Tr Vol #7, page 47
[72] EB-2008-0272, page 30

0272[73]. Third, Hydro One Networks has confirmed that its compensation is still about 17% above the median, as found in the Mercer report[74]. Finally, when Hydro One Networks' full staff complement is taken into account, the increase in head count over the period 2009-2011 is 37% relative to a 33% increase in work programs. As a result, Hydro One Networks has not demonstrated that its higher compensation levels are offset by higher productivity.

Overall, VECC submits there is no new evidence or reason for the Board not to extend a similar reduction in OM&A to Hydro One Networks' Distribution Business and the Board should reduce Hydro One Networks' proposed OM&A by $9 M[75].

To be clear, this proposed reduction to OM&A is in addition to the reductions proposed for the non-wage related reductions discussed under Issue 3.1, the reductions proposed under issue 3.3, and are also in addition to the reductions related to the reduced work plan discussed under Issue 4.6.

3.6 Is Hydro One's depreciation expense appropriate?

VECC has no submissions with respect to Hydro One Networks' proposed depreciation expense other than to observe that it will need to be updated to reflect any changes the Board makes to the Company's proposed capital expenditures and additions for 2010 and 2011.

3.7 Are the amounts proposed for capital and property taxes appropriate?

VECC has no submissions with respect to Hydro One Networks' proposed capital and property taxes.

[73] Tr. Vol #7, pages 56-57.
[74] Tr Vol 6, page 162
[75] VECC notes that in its Draft Rate Order for EB-2008-0272 Hydro One Networks applied the full reduction directed by the Board against OM&A.

3.8 Is the amount proposed for income taxes, including the methodology, appropriate?

VECC's only observation with the respect to Hydro One Networks' income tax calculation is that the Company should reflect the CCA revisions identified in Exhibit H/Tab 3/Schedule 18 in its final Rate Order determination.

3.9 Is the proposed spending on loss reduction efforts appropriate?

VECC has no submissions on this issue.

4. CAPITAL EXPENDITURES and RATE BASE

4.1 Are the amounts proposed for Rate Base appropriate?

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

Hydro One Networks' Position

Hydro One Networks' capital expenditures for Sustaining, Development and Operations increase from $324.8 M in 2008 to $551.6 M in 2010 and $729.1 M in 2011. Hydro One Networks assumes that $152 M and $263 M related to renewable generation and generator connections will be externally funded in 2010 and 2011 respectively[76]. The remaining $399.6 M in 2010 and $466.1 M in 2011 will be funded by Hydro One Networks and recovered through rates[77].

VECC's Submissions

VECC notes that out of the $74.8 M increase in 2010 (over 2008) in rate-funded capital spending $46 M of it is attributable to Hydro One Networks Green Energy

[76] Exhibit A/Tab 14/Schedule 2, page 1
[77] Exhibit D1/Tab 3/Schedule 1, page 2

Plan. Similarly, the $95 M of the $141.3 M increase in 2011 spending (over 2008) is attributable to the Company's GEP[78].

Key drivers for the remaining increases in 2010 ($28.8 M) and 2011 ($46.3 M) are:

- Line Replacements - $10.3 M in 2010 and $29.5 M in 2011 due to end of life and reliability issues[79].
- Customer (Load) Connections - $11.7 M in 2010 and $13.6 M in 2011 due to changes in Regulations and the DSC[80].

VECC's Submissions

a) Scope of Work

As noted above Hydro One Networks' total capital spending program is expected to more than double between 2008 and 2011. Despite Hydro One Networks' claims that it can manage and deliver the increased work, VECC is concerned that dollars will be included in rate payers' bills but not spent during the test period. Under Issue 9.5, for reasons related to the lack of specifics in Hydro One Networks' current Green Energy Plan, VECC recommends the establishment of a variance account to track the GEP spending to allow a true-up against the forecasted spending. In VECC's submission the sheer size of Hydro One Networks' capital spending plan (particularly that associated with its GEP) and the uncertainty as to whether it will be completed is further support for such a variance account.

b) Inflation

A similar issue exists with the updated inflation forecast for Distribution construction costs as is identified and discussed above for OM&A. In the case of construction costs, the cumulative difference in the inflation rate (i.e., over 2009

[78] Exhibit A/Tab 14/Schedule 2, page 1
[79] Exhibit D1/Tab 3/Schedule 2, page 14
[80] Exhibit D1/Tab 3/Shedule 3, page 4 and Exhibit H/Tab 1/Schedule 35

and 2010) used in the Application (1.018*1.013=1.031 or 3.1%) versus that based on the Updated forecast (1.009*0.999=1.008 or 0.8%) is -2.3%[81]. For 2011, the cumulative difference is -2.2%[82].

VECC submits that Hydro One Networks should be directed to use an approach similar to that outlined above for OM&A to estimate the non-wage portion of its capital spending and reduce this amount by 2% for both 2010 and 2011.

c) PST/GST Harmonization

Hydro One Networks Position

Similar to OM&A, Hydro One Networks does not track the PST relating to capital expenditures. However, Hydro One Networks has indicated that a process will be developed to track the PST savings in capital after July 1, 2010 that result from the PST/GST Harmonization. It has indicated that the estimated savings will be tracked in deferral Account 1592[83].

VECC's Submissions

Similar to its submissions regarding Issue 3.1, VECC agrees that a Deferral Account should be established to track the savings that arise post-July 1st, 2010.

d) Distribution System Code Changes (DSC)

During the proceeding VECC's counsel raised what appeared to be two inconsistencies between the Hydro One Networks' application and the recent (October 2009) revisions to the Distribution System Code. The first was with respect to the types of activities that were considered "enhancements" versus "expansions" for the purpose of applying the cost recovery provisions of the DSC to load and non-renewable generation customers[84]. In an undertaking

[81] (1.009*0.999)/(1.018*1.013)
[82] =(1.009*0.999*1.014)/(1.018*1.013*1.013)
[83] Exhibit H/Tab 3/Schedule 21
[84] Tr Vol #6, pages 37-40 and 51-53

response[85], Hydro One Networks indicated that it definition of what was enhancement versus expansion changes depending upon whether the activity arises as a result of the connection of a particular customer or group of customers versus the activity is part of its overall distribution system plan.

VECC submits that the code clearly lays out the definition of enhancement versus expansion and does not make any provisions for altering the definitions as Hydro One Networks has done depending upon the circumstances. VECC acknowledges that under the DSC[86] the cost recovery treatment for certain activities changes depending on whether they are in or out of a distributor's system plan and this may have the same "effect" as Hydro One Networks' approach. However, in the interest of not confusing customers, VECC submits that Hydro One Networks should align its approach with the DSC.

The other issue raised was with respect to the effective date for the DSC changes in cost recovery as they are applied to new non-renewable generators and load connections[87]. In VECC's submission the wording of the revised DSC is clear and the changes should not be applied in the current Application[88].

4.3 <u>Is the proposed level of 2010/2011 Shared Services and Other Capital expenditures appropriate?</u>

Hydro One Networks' Position

Total spending on Shared Services and Other Capital increases from $110.6 M in 2008 to $164.8 M in 2010 before declining to $110.8 M in 2011[89].

VECC's Submissions

VECC notes that the key drivers for the spending increase in 2010 are:

[85] Exhibit J6.5
[86] Section 3.3.1
[87] Tr Vol #6, pages 41-42 and 55-56
[88] Tr Vol #6, pages 55-56
[89] Exhibit D1/Tab 3/Schedule 5, page 2

- Transport & Work Equipment – which increases by $61.9 M due to additional requirements such as the GEGE Act and the transition to a lower vegetation cycle.
- Real Estate – which increases by $25.4 M due to accommodate additional staff plus the new head office space.

It should be noted that these increases are offset by a reduction in spending on the Cornerstone Project which falls from $48.1 M in 2008 to $7.6 M in 2010.

VECC notes that Shared Services capital requirements are facing pressures from a number of fronts: i) the GEGE Act; ii) the desire to increase regular program accomplishments in areas such as vegetation management; and iii) new head office needs. In VECC's view, what is occurring with Shared Services capital spending is illustrative of the "perfect storm" that appears to be hitting Hydro One Networks for 2010 and 2011 and is creating the unprecedented increases in its overall revenue requirement. While each is warranted and may be justified on its own, the combination of events leads to unacceptable consequences for rate payers. This is particularly the case when combined with other factors such as the GST/PST harmonization in 2010 and the Board's new cost of capital policy.

4.4 <u>Are the methodologies used to allocate Shared Services and Other Capital expenditures to the distribution business consistent with the methodologies approved by the Board in previous Hydro One rate applications?</u>

VECC has no submissions regarding this issue.

4.5 Are the inputs used to determine the Working Capital component of the Rate base appropriate and is the methodology used consistent with the methodologies approved by the Board in previous Hydro One rate applications?

Hydro One Networks' Position

For purposes of determining the cost of power component of its working capital allowance Hydro One Networks has used the rate for RPP customers in the Board's April 2009 RPP Report[90]. Hydro One Networks has also indicated that it has no plans to update this calculation[91].

VECC's Submissions

a) Need to Update

VECC notes that in the 2009 Decisions the Board has issued for those Distributors with a cost-of-service based application, the Board's standard practice was to require the working capital allowance to be updated for the most recent RPP Report (typically October 2008 or April 2009 depending on the timing of the Decision). VECC submits that there is no reason why Hydro One Networks should be treated any differently and that it, too, should be required to update its working capital calculation accordingly.

b) Revisions to Cost of Power Calculation

In Exhibit J7.1 Hydro One Networks has provided a calculation of the revised cost of power based on the Board's October 2009 RPP Report. VECC submits that there are two additional adjustments that have to be made to this calculation:

- First, the split between RPP and non-RPP customers needs to be updated to reflect the movement of customers from RPP to non-RPP status as of November 2009. The impact of this revision is shown in Exhibit J7.2.

[90] Exhibit H/Tab 3/Schedule 23, part d)
[91] Tr Vol #8, page 50

- Second, Hydro One Networks will be moving 140,000 customers from bi-monthly to monthly billing beginning in 2010 and finishing by mid-2011. The Company estimates that the full year effect of this move will be to reduce working capital requirements by $13 M[92]. VECC notes that if the implementation is taking place starting in 2010 and finishing by mid-2011, then one could expect roughly 85-90% of a full year's impact to be experienced in 2011[93]. VECC submits that, to account for this, the working capital requirement for 2011 should be reduced by $11 M.

4.6 Does Hydro One's Asset Condition Assessment information and Investment Planning Process adequately address the condition of the distribution system assets and support the O&MA and Capital expenditures for 2010/2011?

In VECC's view, while the spending levels included in the application under the various categories of OM&A and Capital expenditures may be supported by their Asset Condition Assessment information and Investment Planning Process, the circumstances that Hydro One finds itself with respect to the impact of its proposed spending on rates has not been properly reflected in its proposed work plan[94]. VECC respectfully submits that the level of OM&A and Capital spending that should be allowed in Hydro One's 2010 and 2011 rates should be reduced to at or near what is defined by Hydro One Networks as Minimum Level spending.

During the course of the hearing Hydro One set out in some detail its Investment Planning Process, describing how planners develop spending levels for the various categories of OM&A and Capital spending, starting from the Asset Need level, up to the Minimum Spending level and then through to the Level 1 and higher spending levels for approximately 100 areas of spending.[95]

[92] Exhibit K8.5
[93] This assumes a linear phase-in such that conversion is half done by the start of 2011 and completed by mid-year.
[94] Tr Vol #10, pages 36-39 and Exhibit J10.5
[95] Tr Vol 4, pp. 11-37 and 52-53 (in camera), and Exhibits K4.2.

More specifically, Hydro One described how the Minimum Level of spending is developed, providing for a 5 year program of spending that is specifically designed to avoid a situation where the utility takes on an unacceptable level of risk within the 5 year horizon within the approximately 100 areas of spending included in the planning process.[96]

The term "unacceptable risk" is defined by Hydro One to mean a sufficient probability of a sufficiently dire consequence to be avoided within the 5 year horizon; Minimum Level spending in any of the 100 or so areas is sufficient to reduce either the probability of occurrence or the direness of the consequence to within "acceptable" levels within the 5 year planning period.[97] It should be acknowledged that risks of various levels may and will manifest themselves within the planning period; what Hydro One is seeking to avoid is an unacceptably high probability of certain risks occurring, whether they ultimately occur or not.

Hydro One indicated that continued spending into year 6 would, in year 6, put the company in a position of what it determines to be unacceptable risk.[98]

Hydro One's applied for spending in each category is not restricted to the defined Minimum level; Exhibit H, Tab 7, Schedule 39 a) compares the level of spending requested by Hydro One in each area of expenditure to the Minimum Level of spending in each area as determined by the Hydro One planning process. The table below shows the aggregated variance between the As Filed work plan and the work plan based on Minimum Level spending:[99]:

[96] Tr Vol 3, pp. 164-166
[97] Exhibit A Tab 14 Schedule 6 page 8, Table 2 sets out the combinations of likelihood of occurrence and severity of occurrence that Minimum Level of spending seeks to avoid.
[98] Tr Vol 3, p. 166.
[99] Taken from the Tables at pages 2 and 3 of Exhibit H, Tab 7, Schedule 39, response to part a).

	2010 Filed	*2010 Minimum Level*	*Var.*	*2011 Filed*	*2011 Minimum Level*	*Var.*
CAPITAL	564.4	486.6	77.8	577	504.5	72.5
SD&O	356.9	309.1	47.8	379.9	319.2	60.7
Customer Care	106.3	104.8	1.5	102.4	101.8	.6
Shared Services and Other	74.5	62.4	12.2	74.1	62.3	11.8

The interrogatory response indicates, relative to the corresponding Minimum Level of spending;

a) a 15.98% increase in 2010 Capital spending,

b) a 14.37% increase in 2011 Capital spending,

c) a 12.89% increase in 2010 Total OM&A spending, and [100]

d) a 15.13% increase in 2011 Total OM&A spending .

In providing the information in the table Hydro One noted that "the Minimum Level of investment is neither a sustainable or desirable level of investment over the medium term but may be unavoidable because of constraints in the short term."[101]

During the course of the hearing Hydro One confirmed that one of the constraints that is appropriately applied to its spending is consideration of customer impact/ rate increases.[102]

The question that is raised by VECC is whether, in light of the total rate impact of the various elements of Hydro One's rate application and other impacts, it would be appropriate to reduce spending to Minimum or near Minimum Level spending

[100] The Total OM&A figures are a combination of the SD&O, Customer Care, and Shared Services and other categories from Exhibit H, Tab 7, Schedule 39 a).
[101] Exhibit H, Tab 7, Schedule 39, part a).
[102] Tr Vol 3 p. 84-85.

over the course of the two test years. In VECC's view such a reduction over a two year period would be appropriate.

VECC notes, for example, that although Hydro One suggests that rate impacts were considered and provided downwards pressure on requested spending levels, there is a proposed $45 million increase in revenue requirement for 2010 and a $30 million increase in revenue requirement for 2011 as a result of the proposed incorporation of the Board's new policy on Cost of Capital which could not have been considered by Hydro One in its planning process, such policy having been released during the hearing.[103] Indeed, Hydro One has confirmed that it made no specific mitigation proposals or cost reductions in relation to the updated cost of capital parameters it seeks.[104]

As detailed above, VECC has already submitted that the total costs of Hydro One's As Filed capital and OM&A workplans are overstated and should be adjusted. In doing so VECC has essentially proposed that the cost of the As Filed workplan, even if the scope of that workplan is not impugned, is unjustifiably high.

In relation to Minimum Level spending VECC is proposing that additional reductions are available and can be recognized by the Board in terms of the scope of the workplan.

In coming to a final approved Capital and total OM&A budget to underpin 2010 and 2011 rates, VECC submits that it is open to the Board to both:

a) adjust the workplan as filed to reflect appropriate cost escalation and compensation levels, and then

b) reduce the level of work represented by the plan to or near the Minimum Level.

[103] Tr Vol 3, pp. 162-163.
[104] Exhibit J 10.5

VECC submits that as a level of spending that culminates in unacceptable risk after 5 years, it is open to the Board to require Minimum (or nearer) Minimum Level spending for the two test years as a rate impact mitigation measure, given the extraordinary, consecutive year rate increases being sought by Hydro One.

VECC acknowledges that requiring Minimum Levels of spending has the likely effect of deferring costs to future years, and may ultimately increase future costs. However given the current spike in rates sought by the Applicant VECC respectfully submits that it is prudent for the Board to reduce Hydro One's spending to Minimum or near Minimum Level for the test years on the basis that it will continue to avoid an unacceptable level of risk while reducing the immediate rate impacts.

VECC submits that in filing for 2012 rates, Hydro One Networks will inevitably provide information on an updated 5 year horizon of spending that will pick up the effect of 2 consecutive years of near Minimum Level spending, such that 2012 will become year 1 of a new workplan, not year 3 of the current workplan. In this way, even if the Board were to, in theory, continue to require Minimum Levels of spending in two year increments, Hydro One's 5 year planning to avoid unacceptable risk would self correct.

To be clear, VECC is not taking the position that Hydro One Networks should never have rates set at anything other than Minimum or near Minimum level spending; it is simply VECC's view that the rate impact constraints on Hydro One over the test years in this proceeding are such that a reduction to or near Minimum Level spending is required in this case.

As noted above, the filed spending levels for Capital and OM&A expenditures in both 2010 and 2011 exceed the Minimum Level of spending by over 12% in each case, and in most cases much higher than 12%. In VECC's view it would be reasonable for the Board to recognize the rate pressures being imposed on ratepayers over the test years by reducing the scope of the Capital and OM&A spending by 10% in 2010, and 5% in 2011.

To be clear, VECC is proposing a reduction in the scope of the proposed workplan that is in addition to the resetting of the costs of the workplan As Filed. The end result is determined by adjusting the value of the as filed workplan to the appropriate cost level and then reducing the adjusted value of the workplan by 10% in 2010 and 5% in 2011 to reflect a reduction in the scope of the workplan.

In terms of direction with respect to the precise areas to be reduced, VECC does not propose that the Board should micromanage the reductions. To the extent the Board does not require a simple reduction across the Board to the Minimum Level, (as is reflected in the suggestion that the reduction be 10% for 2010 and 5% for 2011 rather than a full reduction to Minimum Levels) Hydro One Networks, VECC would suggest, is capable of reprioritizing its spending to the Minimum level and then adding back in any recovery in excess of the Minimum Level. VECC's only caveat would be any specific directions the Board may have on certain programs, i.e., if the Board were to adopt VECC's submissions with respect to the Vegetation Management Program, the Board would presumably direct that Hydro One make those specific changes within the envelope reductions proposed herein.

4.7 Are the proposed capital expenditures to reduce electricity system losses appropriate?

VECC has no submissions on this issue.

5. CAPITAL STRUCTURE AND COST OF CAPITAL

5.1 Is the proposed Capital Structure and Rate of Return on Equity for Hydro One's distribution business appropriate?

VECC has had the opportunity to review the submissions of CME with respect to the inappropriateness of applying the Board's new Cost of Capital policy to Hydro One Networks and adopts that argument herein.

5.2 Are Hydro One's proposed costs and mix for its short and long-term debt for the 2010/2011 test years appropriate?

Please see VECC's submissions with respect to Issue 1.2.

6. DEFERRAL and VARIANCE ACCOUNTS

6.1 Is the proposal for the amounts, disposition and continuance of Hydro One's existing Deferral and Variance Accounts appropriate?

Hydro One Networks' Position

In its Application Hydro One Networks' reported on the status[105] of its Regulatory Asset accounts. In response to interrogatories, it also provided updated balances for those accounts for which it was not seeking disposition[106]. In terms of disposition, Hydro One Networks is seeking approval to dispose[107] of (by way of refund) a projected December 31st, 2009 balance of ($25.8) M in its Retail Cost Variance, Smart Meters, Retail Settlement Variance and Regulatory Asset Recovery Phase 1 accounts[108]. Hydro One Networks has proposed a two-year recovery period.

VECC's Submissions

a) *Account Balances*

Apart from the minor correction noted in Exhibit J9.7, VECC has no submissions regarding the balances proposed by Hydro One Networks for its Regulatory Asset accounts.

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[105] Exhibit F1/Tab 1/Schedule 1, page 2
[106] Exhibit H/Tab 3/Schedule 33
[107] Exhibit F2/Tab 1/Schedule 1, page 1 (Note: The Smart Meter Balance being disposed of is for December 31, 2008)
[108] In Exhibit H/Tab 3/Schedule 31 the projected balance as of December 31, 2009 was updated to ($30.2) based on actual data to June 30, 2009.

b) Disposition of Accounts

As noted in Board Staff's submissions[109], the usual practice of the Board is to dispose of audited principal balances plus interest. However, with the exception of the Smart Meter account balances, Hydro One Networks is proposing to clear the forecast principal balances in the above noted accounts as of December 31, 2009. When asked for precedents for deviating from the Board's standard practice, Hydro One Networks pointed to its EB-2007-0681 2008 Rate Decision[110].

VECC notes that the Board's rationale for departing from standard practice in EB-2007-0681 was that it would increase the refund to customers and help mitigate the substantial rate impacts to some customers as a result of Hydro One Networks rate harmonization plan[111]. Significant rate impacts due to rate harmonization are present in this proceeding as well. However, this time using the more recent unaudited balances for 2009 as opposed to the audited balances for 2008 will actually increase customers' bills[112] and exacerbate the impact of harmonization and the other factors (such as the new cost of capital policy) which are increasing customers' rates.

VECC submits that there is no reason for the Board to depart from its standard practice of clearing audited balances and requests that the Board approve the disposition of the ($39.3) M audited December 31, 2008 balance (plus interest) to customers.

[109] Page 22
[110] Exhibit H/Tab 1/Schedule 112 a)
[111] Tr Vol #9, page 163-164
[112] Tr Vol #9, page 166

c) Continuance of Existing Accounts

VECC has no concerns regarding Hydro One Networks continued use of its existing deferral and variance accounts.

6.2 <u>Are the proposed new Deferral and Variance Accounts appropriate?</u>

Hydro One Networks' Position

Hydro One Networks is requesting[113] five new variance accounts:

- Pension Cost Deferral
- OEB Cost Differential
- Impact of IFRS Changes
- Fixed Charge for Micro-Fit Generators
- Bill Impact Mitigation

VECC's Submissions

a) Pension Cost Deferral

The main purpose of this account is to capture the impact of the new pension valuation that is going to be effective December 31, 2009 but will not be available until September 2010[114]. Hydro One Networks notes that the impact could be significant but can not be predicted. VECC agrees that it is appropriate to approve the creation of this account.

b) OEB Cost Differential

The purpose of this account would be to track the difference between approved and actual costs for 2010 and 2011 regarding OEB cost assessments, intervenor costs and costs associated with OEB-initiated studies[115]. VECC notes that the precedent offered by Hydro One Networks from EB-2008-0272 was for an

[113] Exhibit F1/Tab 1/Schedule 2, page 1
[114] Tr Vol 10, page 66
[115] Exhibit H/Tab 1/Schedule 118 c)

account that only tracked variances in OEB assessment costs[116]. VECC notes, and the Company acknowledged[117], that the Board denied a similar request in its EB-2007-0681 case. VECC also notes that, more recently, Toronto Hydro was denied a request for a similar account[118]. VECC submits that nothing has changed and there is no reason to grant Hydro One Networks' request in this proceeding.

c) Impact of IFRS Changes

The purpose of this account is to capture the impact on the revenue requirement of any changes in IFRS standards or any significant changes in interpretation of IFS standards that occur during the rate period[119]. The Company acknowledged that the Board, in its EB-2008-0408 Report, declined to establish a variance account to track the impact of IFRS on the revenue requirement[120]. In VECC's view this request is for a very similar account, in that it tracks the impact of subsequent changes in IFRS standards after the initial implementation. VECC submits that, consistent with the direction in its EB-2008-0408 Report the Board should deny Hydro One Networks' request for such an account.

d) Fixed Charge for MICROFit Generators

The purpose of this account is to track the revenues that will be collected from the new fixed charge the Board is proposing to implement for MICROFit generators[121]. During the course of the oral proceeding Hydro One Networks' witnesses were asked about making some provision for these revenues in the approved revenue requirement and then using the approved account to track the variance of forecast versus actual revenues. They agreed that such an approach would be acceptable provided there was a true-up[122]. VECC notes that based on

[116] Tr Vol #9, page 157
[117] Exhibit H/Tab 1/Schedule 118 a)
[118] EB-2009-0680 Decision, page 69
[119] Exhibit H/Tab 1/Schedule 119 b)
[120] Tr Vol #10, page 64
[121] Exhibit F1/Tab 1/Schedule 2, page 2
[122] Tr Vol #9, page 173

the forecast number of annual connections (3,600) and Hydro One Networks propose rates ($6.15) the annualized revenues would exceed $265,000[123], although the value will likely be significantly less in the first year (2010). VECC agrees that the revenue should be tracked. VECC also submits that, in principle, some allowance should be made for the anticipated revenues in the approved revenue requirements for the two years.

e) Bill Impact Mitigation

The purpose of this account is to record any revenue foregone or incremental costs required as a result of completing the harmonization process[124]. VECC seriously questions the need for such an account. Hydro One Networks has stated that it is not proposing to forego revenue as mean of mitigating the impact of harmonization.[125] Also, Hydro One Networks had a similar account approved in for 2008 rates but has not recorded any costs in it[126]. Furthermore, now that the harmonization is underway VECC fails to understand what additional costs could be incurred. VECC submits that, unless Hydro One Networks is being asked to forego revenues as a means of mitigating the impact of harmonization, this request should be denied.

7. COST ALLOCATION and RATE DESIGN

7.1 <u>Is Hydro One's cost allocation appropriate including the analysis of the relationship between density and cost allocation?</u>

Hydro One Networks' Position

Hydro One Networks' cost allocation is performed using the same model as was employed for its 2008 rate application in EB-2007-0681[127]. For this application, Hydro One Networks' used the same density definitions and weighting factors as

[123] Tr Vol #9, page 173
[124] Exhibit F1/Tab 1/Schedule 2, page 2
[125] Tr Vol #10, pages 48-49
[126] Exhibit J9.5
[127] Exhibit G2/Tab 1/Schedule a, page 1

in EB-2007-0681, except that the weighting factor for seasonal customers was set equal to 1.0[128].

In its EB-2007-0681 Decision the Board directed Hydro One Networks to do a more detailed analysis of the relationship between density and cost allocation and stated that the analysis should consider whether the customer class demarcations offer the best reflection of cost causality[129]. In the current proceeding, Hydro One Networks filed a consultant's study that discussed the principles to be taken into account in setting density based rates and outlined various approaches for allocating costs based on density[130]. Based on these results, Hydro One Networks is seeking direction from the Board as to the timing of the process going forward and where to go next[131]. Hydro One Networks is also recommending that the current density approach be maintained until the harmonization of rates process is complete[132].

VECC's Submissions

a) *Appropriateness of Hydro One Networks' Cost Allocation Methodology*

In its EB-2007-0681 submissions[133] VECC raised concerns as to whether: i) Hydro One Networks' use of direct allocation was consistent with the Board's Report on Cost Allocation; ii) the allocation of Administrative and General expenses was in accordance with the Board's Report on Cost Allocation and, finally, iii) the revised Hydro One Networks' allocation of Miscellaneous Charges was appropriate. Hydro One did not respond to any of these issues in it reply submissions and the Board did not address them in its EB-2007-0681 Decision.

[128] Exhibit G1/Tab 2/Schedule 5, page 2
[129] Exhibit A/Tab 18/Schedule 1, page 2
[130] Tr Vol #9, page 11
[131] Tr Vol #9, page 11
[132] Tr Vol #9, page 12
[133] Pages 59-61

However, VECC notes that in its EB-2007-0681 Decision the Board did not explicitly approve Hydro One Networks' cost allocation methodology[134].

In the current proceeding, VECC has identified inconsistencies with respect to Hydro One Networks' application of the Minimum System method that Hydro One Networks has agreed require further investigation and which could lead to changes[135].

VECC submits that the Board should direct Hydro One Networks to address the concerns it has raised in this proceeding and EB-2007-0681 and provide a response as part of its next rate filing. In the interim, VECC submits that, with the minor revisions discussed below under Density Considerations, Hydro One Networks' cost allocation methodology is likely to be sufficiently robust to be used in conjunction with the Board's recommended ranges for customer class revenue to cost ratios.

b) Density Considerations – Board's EB-2007-0681 Directions

Hydro One Networks has indicated that before it proceeds any further on this issue it is seeking direction from the Board on three matters[136]:

1. Whether it is appropriate to maintain urban and rural classes,
2. What definition of urban vs. rural it should use[137], and
3. What methodology it should use to determine the cost differences.

VECC submits that Hydro One Networks approach to this issue is entirely backwards. The Board's primary concern its EB-2007-0681 report was whether Hydro One Networks' existing definitions for density based customer classes best reflect cost causality. In VECC's view, the Board will not be in a position to determine if an urban vs. rural rate differentiation should be maintained until it has more information on what the cost differences would be if customers were

[134] Exhibit H/Tab 7/Schedule 107
[135] Tr Vol #9, pages 143-144
[136] Exhibit H/Tab 7/Scheduel 105 a)
[137] Tr Vol #9, page 138

segmented based on density. As a result, VECC submits that the question of whether it is appropriate to maintain urban and rural classes is the last one to be answered not the first.

VECC submits that if one defines the classes before understanding the implications of density on the differences in costs of serving the customers involved, the resulting cost differentials are unlikely to tell you the real implications of density[138]. As Hydro One Networks witnesses have acknowledged, until you have more information any definition of urban versus rural will just be arbitrary as opposed to cost based[139].

Thus, VECC submits that the first step is to establish a methodology that reasonably captures the cost causation implications of density and then test whether there are urban/rural splits other than the one currently used by Hydro One Networks that better the reflect cost differences that arise due to density. Indeed, VECC submits that this is precisely what the Board directed Hydro One Networks to do in its EB-2007-0681 Decision. To this end, VECC also submits that the use of a couple of simple methodologies (including Hydro One Networks current approach based on customers per kilometer of feeder) would be good starting point.

VECC accepts that 2010 is not the appropriate time to implement changes in customer class definitions. However, given that the density analysis will take some time and effort, now is the time to start the analysis so that the results are available for the Hydro One Networks' next rate filing.

Until such analysis is completed, VECC submits that Hydro One Networks should retain its existing approach for reflecting density in its cost allocation methodology and <u>not</u> change the treatment of seasonal customers as it has proposed to do for 2010.

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[138] Tr Vol #9, page 140
[139] Tr Vol #10, pages 54 and 57

7.2 Are the proposed revenue to cost ratios for each class appropriate?

Hydro One Networks' Position

Hydro One Networks is proposing to reduce the revenue to cost ratios that result from a simple "across the board" increase in rates for the Seasonal, UGSe, and DG classes[140]. In the case of the first two classes the change moves the ratio down to the upper end of the Board's recommended range. In the case of DG, the change moves the ratio down to 100%. Hydro One Networks is also proposing to increase the ratios for the GSd, Street Light and Sentinel Light classes. For the last two classes, the increase will move them to the lower end of the Board's recommended range. For GSd, the class is already within the recommended range. For the remaining classes, the ratio is currently within the Board's recommended ranges and Hydro One Networks is not proposing any changes.

VECC's Submissions

VECC agrees with Hydro One Networks proposed revenue to cost ratios with two exceptions. As noted above the GSd ratio is already within the Board's recommended range. However, the ratio is lower than that for all other classes whose ratios are also currently within the Board's recommended range. The proposed increase is required in order to balance off the proposed decreases to the Seasonal, UGSe and DG classes. In this context, VECC submits that it is inappropriate to increase the ratio for GSd in order to reduce the ratio for the DG class all the way to 100%. VECC submits that the ratio for the DG class should not be reduced below 115% and that any offset be used to moderate the shift for the GSd class.

[140] Exhibit G1/Tab 3/Schedule 1, page 3

7.3 Are the fixed-variable splits for each class appropriate?

Hydro One Networks' Position

Hydro One Networks' proposed "target rates" for it various customer classes (i.e. after harmonization and before any mitigation plans) are set out in Exhibit G1, Tab 4, Schedule 2, page 2. The general approach taken was to adopt the lower of either i) the results of the Avoided Cost Method from the Cost Allocation model or ii) the 2009 service charge of the predominant class in each new customer group[141]. In all cases the proposed 2010 service charges fall within the range established by the Board's EB-2007-0667 Guidelines[142].

VECC's Submissions

VECC accepts Hydro One Networks proposed 2010 target rates for its new customer classes. VECC acknowledges that for many customer classes the fixed charge is not increasing in 2010 for the pre-dominant legacy customer class included in the new customer class definition. However, VECC views this as being necessary in order to facilitate the rate harmonization process that Hydro One Networks is currently engaged in.

7.4 Are the proposed rate impact mitigation plans appropriate and are the resulting customer bill impacts reasonable?

Hydro One Networks' Position

Prior to 2008, Hydro One Networks had 12 rate schedules which were applicable to its legacy retail customer classes along with a set of LV rates which were applicable to embedded LDCs and Direct customers. Hydro One Networks also maintained separate rate schedules for each of its Acquired LDCs which

[141] Exhibit H/Tab 7/Schedule 108
[142] Exhibit G1/Tab 4/Schedule 2, page 2

reflected the applicable customer classes to each. In total, the Company had over 280 customer classes to administer[143].

As part of its 2008 Rate Application, Hydro One Networks proposed 12 new customer classes where virtually all classes consist of customers from both the existing customer classes applicable to its legacy customers and the customer classes applicable to its acquired LDCs[144]. Furthermore Hydro One Networks proposed to harmonize the rates to the customers in all classes. For 8 of 12 new customer classes, this harmonization would take place over a 4 year period (starting with 2008) in order to manage the bill impacts that customers (primarily those of the acquired LDCs) will experience. For the other four classes (DG, ST, Street Lights and Sentinel Lights) the "target" rates were implemented for all customers in 2008.

For 2010 and 2011, Hydro One Networks is continuing with its harmonization plan[145]. However, it has acknowledged that in order to keep the total bill impacts for the "average customer below 10% the harmonization for some acquired utilities may take an extra year[146] as a result of the new cost of capital policy.

The bill impact measure that Hydro One Networks has used in designing the harmonization plan for the remaining 8 customer classes is the total bill for the "average customer" in each customer class for each of the existing customer classes being harmonized[147]. In the case of the various residential classes the average is calculated assuming 1,000 kWhs use per month[148]. Furthermore, the calculation is done taking into account changes in rate riders, loss factors and retail transmission charges as well as distribution rate changes[149].

[143] EB-2007-0681, Exhibit G1, Tab 2, Schedule 1, page 2
[144] Exhibit G1/Tab 2/Schedule 4
[145] Exhibit, G1/Tab 2/Schedule 4, page 1
[146] Tr Vol 9, pages 90-91
[147] Exhibit G1/Tab 2/Schedule 4, page 7
[148] Exhibit H/Tab 7/Schedule 113
[149] Exhibit G1/Tab 7/Schedule 1, page 1 and pages 5-7

Where the total bill impact, even with the phase-in, exceeds 10% for an average customer, the volumetric charge for the customers in the applicable acquired LDC area is reduced as necessary to meet the 10% criteria and the foregone revenues are recovered by increasing the variable charge to Legacy customers in the same group[150].

VECC's Submissions

a) Desirability of Harmonization

As a matter of principle, VECC supports the eventual Hydro One Networks' plan to continue the rate harmonization process it started in 2008.

b) Hydro One Networks Bill Impact Criteria

Hydro One Networks, in assessing customer bill impacts for purposes of designing its rate harmonization and bill impact mitigation plans, has only considered the total bill impact for the "average customer" in each of its original customer classes[151]. Hydro One Networks points to the 2006 EDR Handbook as its justification for this approach[152]. In VECC's view this approach to assessing bill impacts is totally inappropriate under the current circumstances.

The current rate harmonization process involves adjusting not only the average rates paid by the customer in each of the acquired utilities but also moving all of these customers that have been assigned to one of the new rate classes to a common rate structure. In contrast, The 2006 EDR process did not involve any change to rate design that would impact on the bills seen by customers. As result there will be a wider range of impacts across customers within each rate class. Indeed the current process is more similar to the 2002 Rate Handbook[153], where the impact criteria required utilities to look at more than just the average customer. In VECC's view the impact criteria with respect to rate harmonization

[150] Exhibit G1/Tab 8,Schedule 1, pages 1-2
[151] Tr Vol #9, page 68
[152] Tr Vol #9, page 65
[153] Page 4-45

needs to consider more than simply the bill impact for an average customer – as it did in 2002..

A further concern of VECC's is the fact that bill impact criteria does not consider the expected increases in other components of the consumer's bill including: i) the externally funded Green Energy Plan costs, ii) Transmission charges; iii) any new special purpose charges under Section 79.1 or iv) commodity costs[154]. As noted earlier, Hydro One Networks' rationale is that they followed the Board's 2006 Handbook which only required them to consider their (i.e., the distribution business') impact on the total bill.

b) Are Customer Bill Impacts Reasonable?

In VECC's view, the Board can not make a determination as to whether total bill impacts are reasonable unless it considers how the total bill is likely to change. Furthermore, this consideration must include more than just the "average" consumer in each class. In the current proceeding, the Board does not have all the information necessary to calculate bill total likely bill impacts (considering changes in all components of the bill) for 2010 and 2011. However, VECC submits that there is sufficient information available to conclude that the total bill impacts for the majority of customers will be greater than 10%. This conclusion is based on the following:

- Total bill impacts for the "average" customer in many of Hydro One Networks' acquired LDCs will be close to 10% based simply on Hydro One Networks proposal.
- There will be individual customers in both these communities and others that will see impacts in excess of 10%.
- The interim 2010 transmission rates recently approved by the Board will further increase all customers' bills for 2010 and this increase will be even higher if Hydro One Networks is successful in its current review and vary

[154] Tr Vol #9, page 73

motion and permitted to include the impact of the Board's recent cost of capital report in its 2010 transmission rates

- The bill impacts make no allowance for the application of the harmonized sales tax on electricity bills effective July 1st, 2010.
- The bill impacts make no allowance for the increased wholesale market charges that will arise from province-wide recovery of the capital spending related to renewable energy projects that Hydro One Networks (and other utilities) will exclude from their 2010 and 2011 rates.

It is debatable whether Hydro One Networks should be required to mitigate all of the pressures facing consumers' electricity bills in 2010. However, VECC submits that if the Board is to meet its statutory objective "to protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service" it must at least have an appreciation of the bill impacts consumers will be facing when it makes its Decision regarding Hydro One Network's 2010-2011 Rate Application.

Currently this information is lacking and, as result, VECC submits that neither it nor the Board can conclude that the bill mitigation plan is appropriate or that the bill impacts are reasonable.

c) Other Matters

As part of its Application, Hydro One Networks' included a proposed new fixed charge for micro-generators based on the fixed charge credit provided to USL customers[155]. Since the filing of the Application, the OEB has initiated a proceeding (EB-2009-0326) to establish the appropriate charge for micro-generators. VECC has made submissions to Board in that proceeding and, in those submissions, expressed concerns regarding Hydro One Networks' proposal. VECC notes that Hydro One Networks has agreed that its charge for micro-generators will be determined through the EB-2009-0326 proceeding as

[155] Exhibit G1/Tab 4/Schedule 1, page 2

opposed to this current rate proceeding[156]. As a result, VECC will not repeat its submissions here. VECC does request that if the Board's Decision regarding Hydro One Networks' 2010-2011 rates is issued prior to that for the EB-2009-0326 proceeding, then any rate approved for micro-generators should be interim pending the outcome of the generic proceeding.

7.5 Are the proposed Retail Transmission Service Rates appropriate?

Hydro One Networks' Position

Hydro One Networks has used its load forecast (disaggregated by delivery point) and the July 2009 approved uniform transmission rates to estimate its 2010 transmission costs. These costs are then allocated to customer classes based on each class' estimated contribution to the billing determinants for Networks and Connection charges. The Retail Transmission Service Rates are then determined for each class using the forecast billing determinants for the class[157].

VECC's Submissions

VECC has no concerns regarding Hydro One Networks' proposed Retail Transmission Service Rates.

7.6 Is the proposal for regulatory asset rate rider #6 appropriate?

Hydro One Networks' Position

Hydro One Networks proposes to effect its disposition of the Regulatory Asset balance over a two year period[158]. The allocation methodologies for each account generally follow the direction of the Board in its EB-2008-0046 Report with two exceptions[159]:

[156] Tr Vol #9, pages 133-134
[157] Exhibit G2/Tab 3/Schedule 1
[158] Exhibit F1/Tab 2/Schedule 1, page 2
[159] Exhibit H/Tab 7/Schedule 111

- RSVA Wholesale Market Service Charge – where the balance is allocated to classes based on the kWh of each class, excluding wholesale market participants as opposed to on the basis of total kWhs as directed in the Board's report.

- RSVA Provincial Benefit – where the balance is allocated to classes based on the kWh of each class, excluding wholesale market participants as opposed to on the basis of kWhs for non-RPP customers.

VECC's Submissions

VECC's submissions regarding Issue 6.1 addressed the question of the total amount of the disposition. The submission in this section will address the proposed period for disposition and the allocation to customer classes.

a) Disposition Period

VECC agrees with Hydro One Networks proposed two-year disposition period. VECC also agrees with Hydro One that the start date should coincide with the implementation date for Hydro One Networks' 2010 rates and terminate at the planned date for the implementation of the next rate case's rates[160].

b) Allocation to Customer Classes

VECC agrees with Hydro One Networks that the kWhs associated with Market Participants should be excluded from the allocation base used for the RSVA Wholesale Market Service Charges and also for the RSVA Provincial Benefit account. Market participants pay these charges directly to the IESO (as opposed to being billed for them by Hydro One Networks) and therefore should not be included the allocation for purposes of disposing of the variance account balances.

[160] Tr Vol #9, pages 161-162

However, VECC notes that Hydro One Networks is including RPP customers' kWhs in the allocation based for the RSVA Provincial Benefit account. VECC submits that the kWhs for these customers should also be excluded for the same reason, as directed in the Board's EB-2008-0046 Report. For these customers, the Global adjustment (and any ensuing variance disposition) is built into the RPP price. Therefore, it would also be inappropriate to include their loads in the allocation base.

7.7 Are the proposed Distribution Loss Factors appropriate?

Hydro One Networks' Position

Hydro One Networks is not proposing to change its loss factors[161]. It noted that a study filed in its EB-2007-0681 proceeding demonstrated that its current losses were higher than those approved by the Board but that it was making ongoing efforts to reduce its losses.

VECC's Submissions

VECC agrees with Hydro One Networks' proposal not to change its loss factors for 2010-2011 rates. However, VECC notes that by the time of its next rate filing the referenced study will be at least four years out of date. As result, VECC submits that Hydro One Networks should be required to file a new study on losses as part of its next rate application.

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8. SMART METERS

8.1 Is the 2010/2011 smart meter O&M and Capital budget appropriate?

8.2 Are the amounts for Smart Meter related variance accounts appropriate?

8.3 Is the treatment of stranded meter costs appropriate?

8.4 Is Hydro One's regulatory treatment of Smart Meter costs appropriate including the smart meter funding adders proposed for 2010/2011?

Hydro One Networks' Position

As part of its pre-filed evidence, Hydro One Networks provided its projected OM&A and capital spending on smart meters for 2010 and 2011[162]. Hydro One Networks is also proposing to include in rate base as of January 1, 2010 all costs for smart meters installed as of December 31, 2008. Hydro One Networks states that there are no costs associated with stranded meters in 2010 or 2011[163].

VECC's Submissions

VECC examined Hydro One Networks' proposed smart meter costs and treatment during both the interrogatory and the oral phases of the proceeding. and has no concerns regarding Hydro One Networks' proposals. VECC's only observation is that the calculation of the income taxes associated with the smart adder should be updated, if required, to reflect the impact of the revise CCA rates identified in Exhibit H/Tab 3/Scheduel 18.

[162] Exhibit F1/Tab 1/Schedule 3, page 6
[163] Exhibit F1/Tab 1/Schedule 3, page 1

9. GREEN ENERGY PLAN

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?

Green Energy and Green Economy (GEGE) Act, 2009 and the Board's Filing Guidelines

The *GEGE Act* included two new objectives for the OEB:

4. To facilitate the implementation of a smart grid in Ontario.
5. To promote the use and generation of electricity from renewable energy sources in a manner consistent with the policies of the Government of Ontario, including the timely expansion or reinforcement of transmission systems and distribution systems to accommodate the connection of renewable facilities.

To put effect to these new objectives the *GEGE Act* requires that all transmitters and distributors prepare and file with OEB for approval plans that address the expansion of their systems to accommodate the connection of renewable generation resources and the development and implementation of the smart grid.

In order to provide guidance to transmitters and distributors regarding the Board's expectations, on June 16, 2009 the OEB issued Guidelines (G-2009-0087) for distributors and transmitters seeking to prepare the requisite plans[164]. These Guidelines state that the Plan should contain:

- An assessment of the Distributor's current capability to accommodate the connection of renewable generation and/or it state with respect to the development of a smart grid.
- A long term outlook as to how the distributor expects its system to evolve over the next five years to accommodate renewable generation projects likely to be developed and/or the smart grid features that the distributor expects to see. This section of plan is expected to include information on

[164] Exhibit K3.4, pages 9-14

the benefits of the proposed evolution, how the benefits will be assessed against cost and how the expenditures will be prioritized.

- A detailed description of the activities expected to occur within the plan's first three years and their costs.

Hydro One Networks' Position

Hydro One Networks is requesting the Board to accept Its Green Energy Plan as fulfilling its obligations to file a plan pursuant to Section 70 (2.1) of the GEGE Act[165]. Hydro One Networks is also requesting that the Board approve the levels of spending set out it the plan for 2010 and 2011 for rate making purposes. Hydro One Networks also indicated, during the proceeding, that it had filed its Plan pursuant to the Board's Guidelines[166].

VECC's Submissions

The requirements and expectations regarding the "Plan" to filed by distributors (here forth referred to as a "Green Energy Plan" or "GEP") are new and still evolving as evidenced by the draft "Filing Requirement: Distribution System Plans under the Green Energy Act" issued by the Board for comment on December 18, 2010. In addition, distributors are still waiting for even the initial results from the new FIT and MicroFIT pricing now being offered by the OPA[167]. As a result, Hydro One Networks' GEP, as it pertains to the accommodation of new renewable generation, was not based on a responding to a specific set of known requirements[168] but rather provided information, based on previous experience, as to how much new renewable generation it expected to connect over the next two years[169] and how it would be distributed proportionately across the province[170].

[165] Tr. Vol. 11, page 18
[166] Tr. Vol. 1, page 159
[167] Tr. Vol. #1, page 47 and pages 106-107
[168] Exhibit H/Tab 7/Scbhedule 20
[169] Tr. Vol. #2, page 29
[170] Tr. Vol. 1, pages 147 -149

The capital projects it has identified as undertaking to accommodate new renewable generation are “representative” of what investments may be required[171]. Indeed, while the Plan sounds quite precise in that it includes the costs of 12 new breaker position, 360 kilometer of new express feeders, 30 kilometers of feeder upgrade and 6 Distribution Station capacity upgrades[172], facilities will not be built until Hydro One Networks knows where the connections are going to occur. There is not a lot of specific project information available right now[173] and Hydro One Networks does not know, at this time, precisely what facilities will be required[174].

A similar situation exists with respect to Hydro One Networks’ planned activities and proposed expenditures with respect to smart grid. The smart grid portion of its GEP includes a number of studies and an RFP for vendors to participate in smart grid pilot investments with a view to evaluating various technologies that would be part of the smart grid. Until the results of the RFP are known the precise activities to be under taken in the Smart Zone Pilot will not be known[175], nor will the associated costs[176]. Furthermore, until the Smart Zone Pilot has been completed, details as to what full implementation of a smart grid is to entail will not be known[177]. Lastly, the planned studies are part of a multi-year process to determine what new technologies and processes it should be implementing[178]. As a result, VECC submits that the smart grid costs and activities included in the 5-year plan are not completely defined and somewhat speculative for the later years.

VECC wants to be clear that the preceding comments are not meant to be particularly critical of Hydro One Networks’ Plan or the level of information it has filed to support its Plan. In VECC’s view any inadequacies and lack of further

[171] Tr. Vol. 1, page 155-156 and Vol. #3, page 50
[172] Exhibit D3, Tab 2, Schedule 3, Program D29
[173] Tr. Vol. #2, page 185.
[174]Tr. Vol 2, pages 191-192
[175] Tr. Vol. #2, page159
[176] Tr. Vol #1, page 40
[177] Exhibit D1, Tab 3, Schedule 3, page 24
[178] Tr Vol #6, page 44

precision are largely a function of the fact that it is early days for Ontario in terms of implementation of the GEGE Act and the acquisition of additional renewable generation. Plans will improve as more information (both in terms of OPA's contracts for new renewable generation and the OEB's filing requirements) becomes available.

Overall, VECC submits that Hydro One Networks' GEP should be considered as having appropriately responded to the filing requirements of the Board and objectives of the *GEGE Act*, given the limitations it currently faces. However, as discussed under Issue 9.4, these limitations are material and mean that the OEB should not give full approval to Plan. VECC's submissions regarding "approval" will also be addressed under Issue 9.5.

9.2 Has Hydro One appropriately addressed the Green Energy Plan expenditures in the context of its overall Capital and O&M budgets?

Hydro One Networks' Position

Hydro One Networks has included the costs associated with the Green Energy Plan in its overall Capital and OM&A budgets submitted as part to the Rate Application. It has also, in Exhibit A, Tab 14, Schedule 2, outlined the "direct" costs associated with those activities that comprise its Green Energy Plan[179].

VECC's Submissions

In VECC's view Hydro One Networks has appropriately addressed the "direct" spending associated with its Green Energy Plan. However, it is clear that Hydro One Networks' response to the GEGE Act has given rise to additional "indirect" costs that are included in the proposed revenue requirements for 2010 and 2011 but are not reflected in the Plan as filed[180]. During the course of the oral proceeding Hydro One Networks indicated that there was approximately $10 - $15 M in indirect costs included its revenue requirement related to its Green

[179] Tr Vol #3, page 48
[180] Tr Vol #3, page 81

Energy Plan[181]. However, Hydro One Networks' witness made it clear that this was a "high-level estimate".

VECC notes that references to the impact of the *GEGE Act* can be found throughout not only the description of OM&A spending for Operations, Development and Customer Care but also throughout the rationale for increased spending on a number of the shared services functions. Examples include Asset Management[182] and Corporate Functions and Services[183]. There is also additional capital spending (over and above that in the GEP) that is attributed to the *GEGE Act* for Real Estate[184] and for Transport & Work Equipment[185] which will impact the revenue requirements for 2010 and 2011.

In response to the issue, VECC submits that Hydro One appears to have incorporated in its proposed OM&A and Capital spending for 2010 and 2011 both the direct and the indirect impacts of its Green Energy Plan. However, it has not been able to clearly point out what the ultimate and overall impact on the revenue requirement is. This shortcoming is unfortunate, particularly in light of the significant increases in revenue requirement and distribution rates that Hydro One Networks is requesting for 2010 and 2011[186]. The Board should indicate to Hydro One Networks that, in the future, more specifics are required as how key cost drivers (such as changes in legislation) have impacted its requested revenue requirement.

9.3 <u>Is Hydro One's methodology for allocating Green Energy Plan O&M and Capital costs between the OPA (Global Adjustment Mechanism) and Hydro One appropriate?</u>

The Board has determined that this issue will be dealt with after it has issued its EB-2009-0349 Report. However, the question exists as to how the issue should

[181] Tr Vol #4, page 159
[182] Exhibit C1, Tab 2, Schedule 6, page 4
[183] Exhibit C1, Tab 2, Schedule 7, pages 2 and 4
[184] Exhibit H/Tab 12/ Schedule 29
[185] Exhibit H/Tab 7/Schedule 92
[186] Exhibit J4.4

be managed in the Board's determination regarding Hydro One Networks' 2010-2011 revenue requirement. VECC has reviewed OEB Staff's submissions and submits that the alternate proposal put forward by Staff is a preferred approach to that suggested by Hydro One Networks. VECC notes that this approach is consistent with its recommendations that the GEP (and related spending) be approved on an interim basis subject to final confirmation at a later date. VECC submits that at this later time the Board could also finalize the determination of the "direct benefits".

9.4 To what extent should the Board approve any projects or expenditures relating to the Green Energy Plan that are scheduled to occur beyond the test years (i.e. 2010 and 2011) in the current application?

Hydro One Networks' Position

Hydro One Networks has clearly stated that it is only looking for approval of the GEP spending proposed for the test years 2010 and 2011[187]. It is not looking for approval of cost beyond the test years. Rather, its expects at the time of its next rate filing to update its Green Energy Plan and seek approval for the subsequent years' expenditures at that time[188].

VECC's Submissions

VECC agrees with Hydro One Networks' approach and submits that that the Board should not approve any of the projects or expenditures relating to the Green Energy Plan that are scheduled to occur beyond the test years. As discussed in response to Issue 9.1 there is a considerable uncertainty (particularly in the area related to renewable generation) as to specifically what projects Hydro One Networks will be undertaking even in test years and this uncertainly only grows beyond the two-year test period. Furthermore, as Hydro

[187] Tr Vol #11, page 18
[188] Tr Vol 1, pages 158-159

One Networks notes, it will have gained considerable experience by the time it returns for its next rate application[189].

Furthermore, VECC notes that under the GEGE Act[190], once a Plan is approved by the OEB the distributor is required to expand its system and make smart grid investments in accordance with the Plan. Given the uncertainty (and therefore lack of specificity) as to the activities and projects that will be undertaken beyond the rate year, VECC submits that Plan does not provide sufficient detail for the Board – by its approval – to provide such an authorization.

9.5 What is the Board's role with regard to the approval of the Green Energy Plan? What criteria should the Board use when determining whether to approve the Green Energy Plan? If the Board approves the plan, what are the impacts of that approval?

VECC's Submissions

As noted above, one of the key impacts of Board approval of a GEP is that the transmitter/distributor is then authorized (indeed required) to implement the Plan as approved. Furthermore, under the Board's G-2008-0087 Guidelines, issues of need, project selection, project budget and prioritization of expenditures that are addressed through the plan approval will not be revisited except in relation to material deviations[191].

Given these implications, VECC submits that full approval of a Plan should not be provided unless there is sufficient information for the Board to make a determination that the activities include in the plan are needed, that the specific projects proposed represent the preferred approach, and that the budgets are appropriate.

[189] Tr Vol #1, pages 158-159
[190] OEB Act, Section 70 (2.1) 3.
[191] Exhibit K3.4, page 14

As noted above, VECC is of the view that Hydro One Networks' Plan is not sufficiently well defined to permit the Board to provide any approval for the years beyond the test period. VECC submits that the Plan for these years should not be "approved" within the meaning of the OEB but rather "received" by the Board as providing appropriate context for the proposed activities within the two-year test period.

With respect to the proposed Plan for the test year period (2010-2011), VECC submits that Hydro One Networks has justified the need for the types of activities it is proposing to undertake. However, in the case of renewable expansion and enabling investments the Plan does not include specific projects and therefore the Board is not in a position to authorize budgets or provide an approval that would "require" a specific project to be undertaken. A similar situation exists for smart grid spending since the RFP has not been completed and the resulting projects (and accompanying project justification) provided to the Board.

To address this issue, VECC proposes that the Board grant conditional or interim approval to first two years of the plan, approve a rate rider to fund the GEP at the proposed budget level and establish a variance account to record difference between the actual and approved revenue requirement impacts of Hydro One Networks' GEP projects. Final approval of the Plan would be granted when Hydro One Networks filed for disposition of the variance account.

VECC notes Hydro One Networks' key concern regarding the approval of its GEP is that it have sufficient funding to implement the Plan[192]. VECC submits that its proposed approach would address this concern and notes that Hydro One Networks is generally supportive of such an approach[193]. The only concern it expressed was with respect to the new IFRS requirement as they relate to variance accounts that are subject to future true-up. In VECC's view this concern is misplaced. First, VECC notes that Hydro One Networks is (itself) proposing the

[192] Tr. Vol #3, page 75 and Vol 4, page 226
[193] Tr. Vol #3, page 76 and Vol 4, page 227

introduction of new variance accounts[194] for 2010 and therefore the IFRS concerns can not be seen as insurmountable.

COSTS

VECC requests that it be awarded 100% of its reasonably incurred costs in connection with this matter.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 5th DAY OF FEBRUARY 2010

[194] Exhibit F1/Tab 1/Schedule 2