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BY COURIER

March 10, 2010

Ms. Kirsten Walli
Secretary
Ontario Energy Board
2300 Yonge Street, Suite 2700
Toronto, ON
M4P 1E4

Dear Ms. Walli:

EB-2009-0349
Hydro One Networks' Comments on Rate Protection and the Determination of Direct Benefits

As requested in the Board's letter of February 5, 2010, Hydro One Networks Inc. ("Hydro One") is pleased to offer some additional comments regarding EB-2009-0349, the Board's policy initiative dealing with Rate Protection and the Determination of Direct Benefits under Ontario Regulation 330/09 and Section 79.1 of the *Ontario Energy Board Act, 1998* ("the Act").

The Board Staff Discussion Paper ("the paper") was issued on December 14, 2009, and Hydro One provided extensive comments on that paper on January 13, 2010. The additional comments provided here highlight some key issues, especially where Hydro One is further informed by

- the Board's Partial Decision of February 18, 2010 in EB-2009-0096. That decision pertains to the allocation methodology set out in Hydro One's Green Energy Plan, filed in Hydro One's distribution rates application (Exhibit A, Tab 14, Schedule 2)[1] ; and
- discussions with other parties, including the stakeholder session that Board staff held on session of February 26, 2010 (presentation attached).

[1] "The Board approves the methodology proposed by Hydro One in this rates proceeding for the allocation of Green Energy Plan costs for rate setting purposes, <u>on a provisional basis</u>. The consequences of this approval will be reflected in the Rate Order arising from this case. The allocation methodology and the resulting responsibility for Green Energy Plan costs for 2010 and 2011 will be subject to later revision to reflect the Board's final policy determination in EB-2009-0349. Deferral accounts will be established to track the difference between the allocation provisionally approved in this decision and the allocation that will be established as a result of the Board's policy. Hydro One will apply the results of that Board policy when it applies for disposition of the deferral accounts for 2010 and 2011.

The use of rate adders, the amounts to be allocated and the definitions of the deferral accounts will be established in the final decision in this proceeding."

Allocation of Direct Benefits in the Context of Connecting Renewables

While the objective of the Board's policy initiative is to meet and implement the requirements of O. Reg. 330/09, Hydro One's view is that the proper allocation of direct benefits is not an 'end in itself'. The ultimate goal is the connection of renewable energy generation, as contemplated by the policies of the Government of Ontario.

Hydro One remains concerned that the ultimate methodology and requirements determined through this proceeding may unduly distract distributors from the connection of renewables. The resources (dollars, staff and time) needed to estimate the direct benefits will ultimately be paid for by customers – generators, distribution ratepayers, or provincial consumers -- and as such they must be kept reasonable.

Scarce resources must be focused on connecting renewable energy generators. These are the same planners, estimators, and even field personnel that could be needed to determine direct benefits, depending on the methodology that the Board ultimately adopts.

Hydro One encourages the Board to ensure that any methodology that it develops remains consistent with the Board's fifth objective under Section 1. (1) of the Act, namely "… *timely expansion or reinforcement of Ontario's electricity grid to accommodate connection of renewable energy generation."*

Materiality of the Benefit Must Justify the Effort to Quantify it

From discussions subsequent to the release of the paper, Hydro One notes that the Board and interested parties must continue to focus on the *value* that can be derived from increased accuracy and precision in allocating direct benefits. The costs of attaining this value must not be allowed to exceed the value itself. Excessive requirements for rigorous assessments will lead to higher costs and will consume scarce resources, with questionable payback.

Specifically, Hydro One encourages the Board to develop a policy that

- focuses on the "low hanging fruit", namely the more obvious, proven and material benefits, quantified in a reasonable (not necessarily 'perfect') manner; and
- applies to all distributors a common, reasonable yardstick for rigour & precision.

Hydro One was pleased to learn through the consultation to date that Board staff did not intend in the Paper[2] to suggest that a different standard of rigour or precision would be applied to different distributors, for example based on their size. Hydro One understands that there may be certain types of eligible investments that may merit more analysis than others, and we would welcome this clarification in the Board's final policy.

[2] "The level of detail and analysis provided by a distributor underlying the estimation of the direct benefits should be commensurate with the circumstances of the distributor."

Steer Clear of Project-Specific Allocation

Hydro One's earlier submission stated "Hydro One is not supportive of an approach that would require this calculation to be done for every project separately, since it requires field asset checks and valuation for each individual project and can be labour-intensive and time-consuming."

Since this consultation was initiated, Hydro One has had the opportunity to further explore the implementation aspects of its own proposed allocation of direct benefits, as well as other scenarios that may emerge from this proceeding. At this time, Hydro One is even more concerned about the implications of any approach that would require the attribution of direct benefits at the project-specific level, as

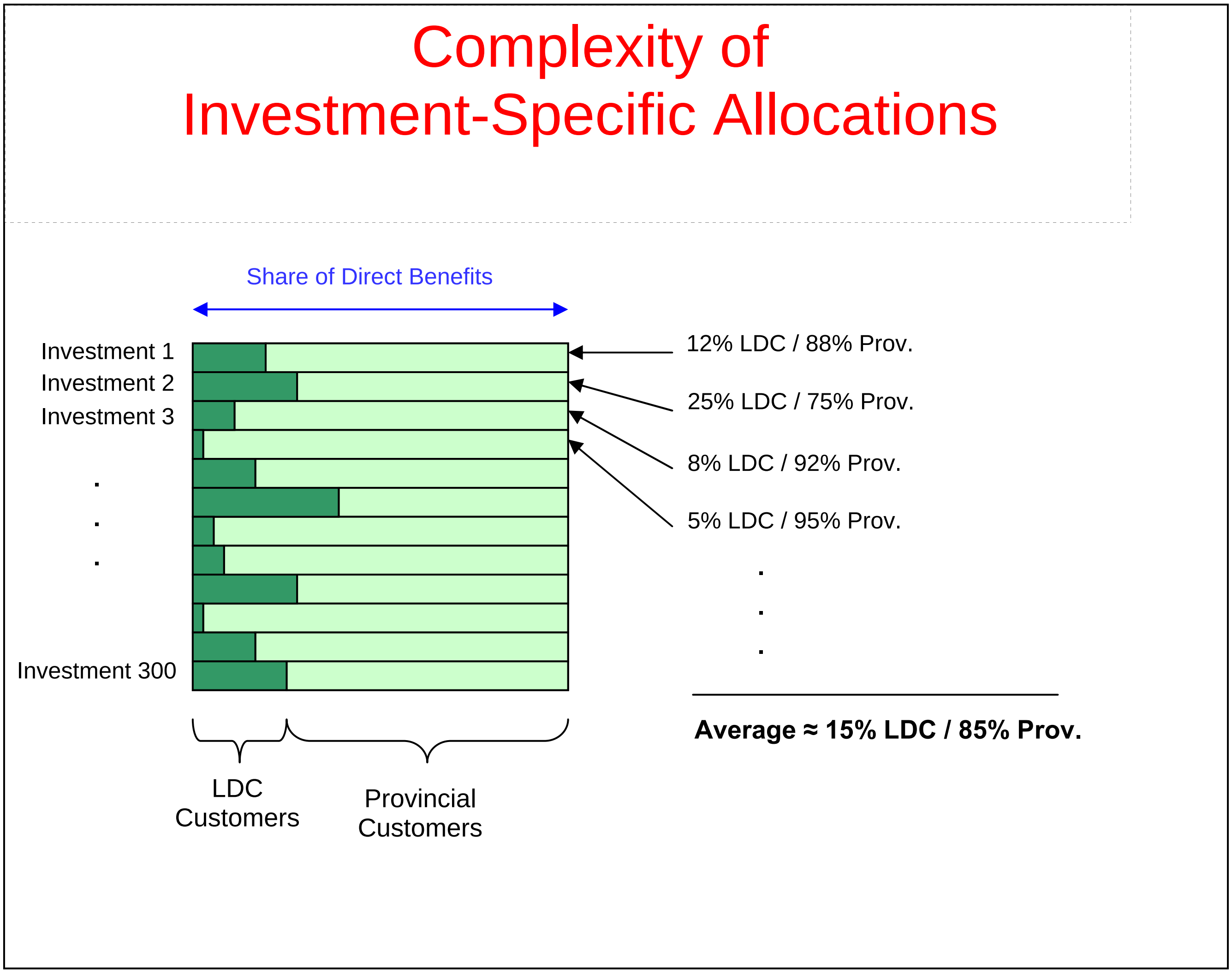
- it may not improve precision,
- it will increase complexity and cost,
- a separate calculation for each project is labour-intensive and time-consuming, and may need to be repeated as new connections occur,
- density and load growth information is unavailable at the feeder / station level, and
- there may be significant additional complexity due to IFRS and variance accounting.

An *ex post* approach at the project level would likely require revisiting each project and its components, not only financially (using more detailed project costing and tracking than would otherwise be required), but even in the field (to assess asset and customer information specific to each project, possibly on a repeated basis as circumstances change). This could lead to the need to examine each project pole-by-pole, circuit by circuit, and for various other asset types, to determine their condition, age and function.

Any attempt to allocate project-specific direct benefits on an *ex ante*, or planned basis would be hampered by the fact that distributors will not know in advance all the specific investments, which may be in different stages of planning.

The hypothetical illustration below demonstrates the complexity of attributing direct benefits that may differ for each project. Hydro One has identified over 300 expansion projects in 2011, and such an effort would introduce significant problems. Recognizing this, our Green Energy Plan uses an aggregate approach for each category of investments, which Hydro One believes reasonably reflects the average outcome of all planned projects.

Hydro One believes that an aggregate approach is consistent with other aspects of regulation, where a "pooling approach" is used.



The "Ex-post" Approach is Problematic

Hydro One has already urged the Board to retain an ex ante approach for determining direct benefits, consistent with existing regulation in Ontario, i.e. forward-looking rate-making.

In addition to our earlier observations that an ex-post process requires significant and labour-intensive effort due to the complexity of after-the-fact calculations, we note that, should the Board require any ex post analysis, it is imperative that all expectations be articulated in advance. Otherwise, there is the risk that distributors would not have access to the required information, especially if it is not needed for purposes other than the direct benefit calculations.

Experience will be gained over the coming years

Hydro One views the Board's Partial decision of February 18, 2010 as a provisional approval of a "Beta version" methodology for determining direct benefits.

Hydro One would like to see the Board continue to use an incremental approach to developing this policy, as the policy progresses to "Release 1.0" and through subsequent refinements.

This approach would allow the Board and other parties to

- gain experience to allow transition to a common set of guidelines in the future, if appropriate, and
- initiate specific studies to build the knowledge and experience.

Then, a common set of guidelines be developed.

During this consultation, Hydro One was asked for examples of studies and areas for further development. For example, Hydro One believes that addressing any 'benefits' from WMSC and Transmission charges should be a "Release 2.0" initiative, and that the Board could initiate studies, possibly as part of the Regulatory Reporting Requirements, that would help assess the information and methodologies to develop this aspect of the policy. Hydro One acknowledges and accepts the views of certain parties in this proceeding that these "benefits" are arguably not "direct" benefit that can be attributed to eligible investments. In any case, the benefits are not significant during initial implementation, but the cost of the required information and analysis could be significant.

Similarly, the Board may wish to conduct assessments of various types of eligible investments, to determine which, if any, justify more rigorous analysis.

IFRS

During this consultation, Hydro One has considered the implementation aspects for direct benefits in the context of the transition to the IFRS accounting practices.

Hydro One notes that IFRS requires componentization of property records (e.g. individual transformers, poles, etc.). The allocation of direct benefits would, in addition, require distributors to assign a portion of every asset in an investment to a provincial rate base & revenue requirement, in addition to the LDC's own customers' rate base and revenue requirement.

A project-specific approach could require allocating individual asset components using different splits. Even for distributors who have robust IT and accounting systems, a "project-specific" approach would pose regulatory and accounting challenges.

Finally, as the Board's policy develops, there may be a need to change the allocations of direct benefits over time. Hydro One notes that, while manual interventions may be needed to accommodate such changes, these can be minimized if retroactive adjustments are avoided.

Conclusions

Hydro One has shared the following colloquial “key messages” with other parties in this consultation, and offers them to the Board for its information.

- Precision and accuracy come at a cost
- Focus on the goal: Connecting renewables
- Avoid project specific approach
- Focus on material benefits
- Stick to ex ante/ planning approach
- “Park” WMSC & Transmission Charges for now
- Walk before we run , and let’s learn as we go

Sincerely,

ORIGINAL SIGNED BY SUSAN FRANK

Susan Frank

Attach.

Comments on Board Staff Discussion Paper

Determination of Direct Benefits
EB-2009-0349

Hydro One Networks Inc
February 26, 2009

Remember Our Goal:
Timely, efficient connection of Renewables

- Methodology must be consistent with
  timely expansion or reinforcement of Ontario's electricity grid to accommodate connection of renewable energy generation.
- Scarce resources must be focused on connecting renewable energy generators.

Materiality of benefit must justify the effort to quantify it

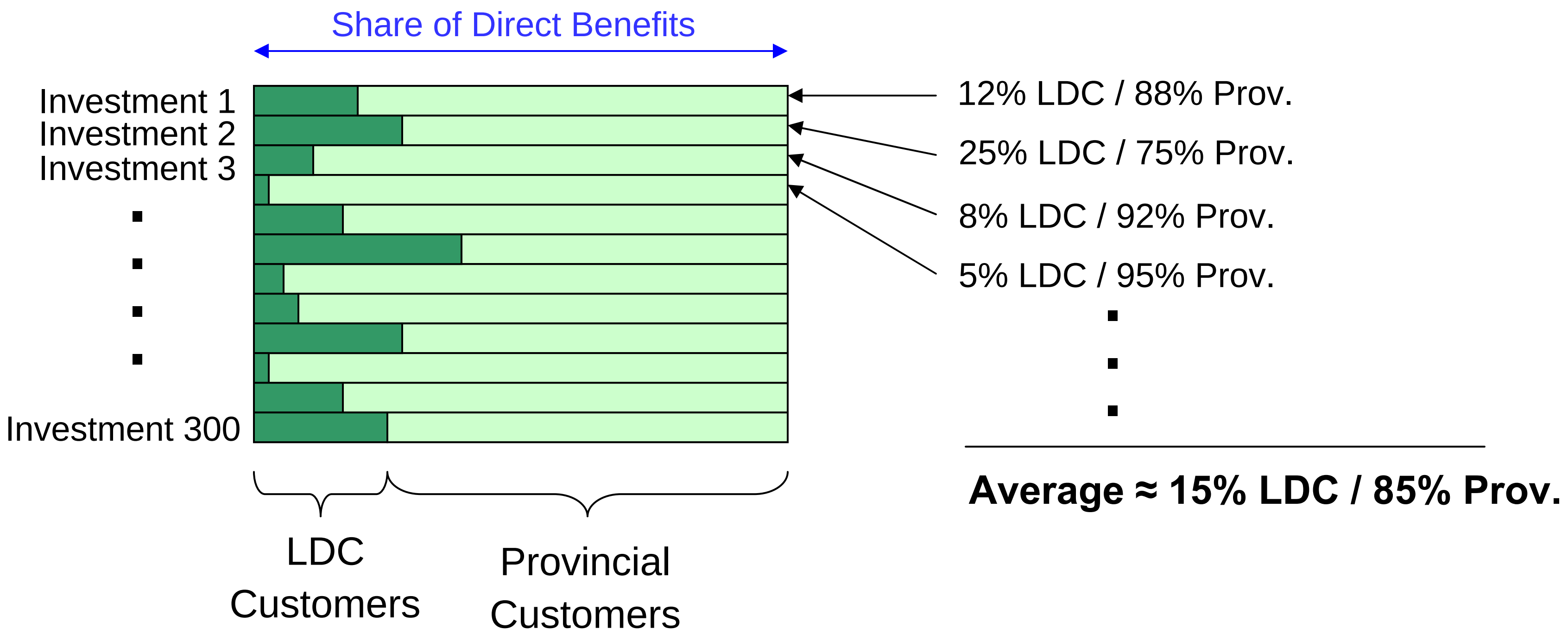
- Value from increased accuracy & precision must outweigh costs.
- Excessive requirements for rigorous assessments will lead to higher costs, with questionable payback.
- Focus on the more obvious & material benefits, quantified in a reasonable manner.
- Apply to all LDCs a common, reasonable yardstick for rigour & precision.
- In future, assessment requirements can vary, based on the type of eligible investments.

Steer Clear of Project-specific Allocation

- It may not improve precision,

  but it will increase complexity and cost.
- Separate calculation for each project is labour-intensive and time-consuming.
- Density and load growth information unavailable at feeder / station level.
- Potentially significant additional complexity due to IFRS and variance accounting.

Complexity of Investment Specific Allocations



The “ex-post” approach is problematic

- Inconsistent with existing regulation in Ontario, which is forward-looking rate-making.
- An ex-post process requires significant and labour intensive effort due to the complexity of calculation.
- All expectations must be articulated up front – otherwise the required information may not exist.

Experience will be gained over the coming years

- Need to gain industry experience to allow transition to a common set of guidelines in the future, if appropriate
- Insufficient industry experience today.
- Distributors wishing to access provincial consumer funding should file their own proposals for the allocation of direct benefits (part of Cost of Service Application and GEA plans).
- The Board should initiate specific studies to build the knowledge and experience.
- Only then can a common set of guidelines be set.

Reduced Network Transmission and WMSC Charges

- Arguably not a potential source of “direct” benefit
- Not proposed by Hydro One
- Limited reduction in Transmission charges due to generation characteristics
- Benefits not significant during initial implementation
- Micro-generators should be excluded

Improved System Capability
Guiding Principles in Paper

- Default: Eligible investments have zero benefit to LDC customers unless these can be monetized.
- Same level of detail should apply to all distributors.
- Not all asset replacements benefit LDC customers.

+

- Methodology should not hinder the timely and efficient connections of renewable energy generators.
- Materiality should be considered to balance the incremental costs associated with determining benefits.

Improved System Capability
Board Staff's Proposed Criteria

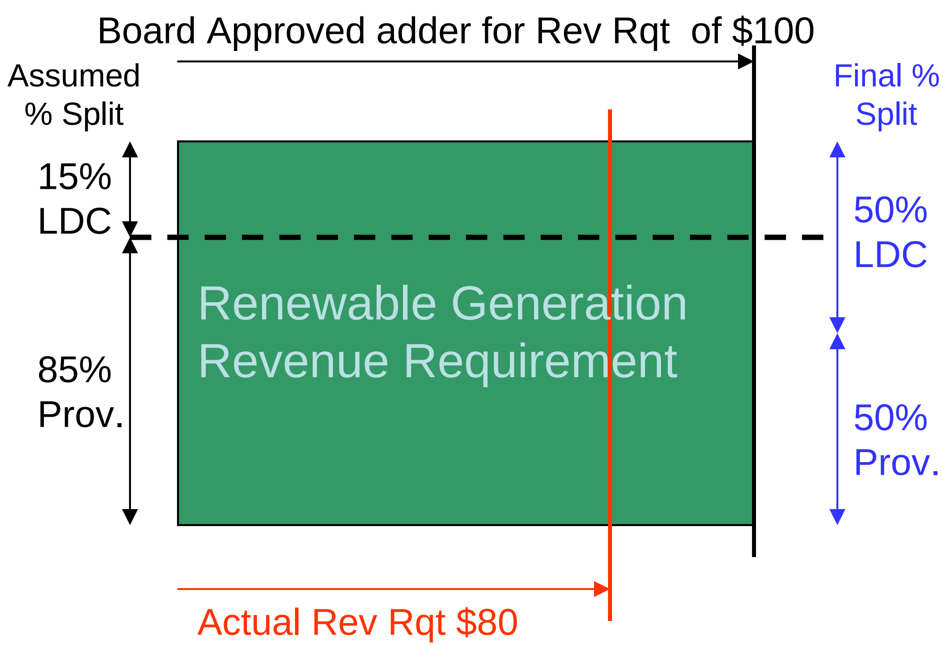
- ❑ Portion of Eligible Investments not used by Qualifying Generators
- ☑ Customer Load Growth
- ☑ Asset Condition
- ❑ Size of Renewable Energy Generator(s)
- ☑ Service Quality Improvements
- ❑ Line Losses

Summary of Hydro One's GEP

- Asset Replacement (Expansions)
  - Age as proxy for wood pole condition (population sample)
  - Other assets not material
  - 15% of new investments benefit LDC customers
- Load Growth (Expansions)
  - Assumed load growth across system
  - Identify feeders that would require investment
  - 3% of new investment benefits LDC Customers
- "Service Quality" (REI)
  - Station automation / SCADA (9%)
  - Auto Reclosers (5%)
  - Many REI investments do not benefit LDC Customers (0%)

Implementation In the Face of Uncertainty

(adders, variance accounts, & riders)



	LDC	Prov.	Total
Recovery based on Board approved adder	$15	$85	$100
Revenue requirement based on final % split	$40	$40	$80
Disposition via rate rider at future COS	Collect $25	Refund $45	Net Refund $20

IFRS makes it worse!

- Requires componentization of property records (e.g. individual transformers, poles, etc.)
- Need to assign a portion of every asset in an investment to provincial rate base & revenue requirement
- A project-specific approach could require allocating individual asset components using different splits
- Even with robust IT systems, “project-specific” poses regulatory & GAAP accounting/ reporting challenges.
- IFRS will now reclassify overhead costs to OM&A, so these, too, may need to be allocated between the provincial and LDC revenue requirements
- Manual intervention if allocations change over time

Recommendations and Next Steps

- Precision and accuracy come at a cost
- Focus on the goal: Connecting renewables
- Avoid project specific approach
- Focus on material benefits
- Stick to ex ante/ planning approach
- “Park” WMSC & Transmission Charges
- Walk before we run &   Learn as we go