EB-2010-0002

THE ONTARIO ENERGY BOARD

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

AND IN THE MATTER OF an application filed by Hydro One Networks Inc. under section 78 of the *Ontario Energy Board Act, 1998* for an Order or Orders approving or fixing just and reasonable rates and other charges for the Transmission of electricity for 2011 and 2012.

Written Argument Of
The Consumers Council of Canada

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WRITTEN ARGUMENT OF THE CONSUMERS COUNCIL OF CANADA

I INTRODUCTION AND OVERVIEW

1. Hydro One Networks Inc. ("HON") has applied to the Ontario Energy Board ("Board") for approval of a revenue requirement of $1.446 billion in 2011 and $1.547 billion in 2012 and of the rates derived therefrom. If approved, this would result in Transmission rate increases of 15.7% in 2011 and 9.8% in 2012. The rates would become effective on January 1, 2011.

2. This is the Written Argument of the Consumers Council of Canada (the "Council") in the application. The Council begins with an overview of three general issues which, among other things, provides the context for consideration of the application. The Council will address most of the issues on the issues list. In the preparation of this Written Argument, the Council has cooperated with other parties and, where appropriate, either adopted their arguments or deferred to them.

3. The application gives rise to three general issues which, we submit, should both inform the Board's approach to the overall application and which should influence the Board's determination of certain specific issues.

4. The first of the general issues is whether, or to what extent, the Board should consider the impact of the relief which HON seeks on the total bill paid by the typical residential consumer. We will refer hereinafter to this issue as the total bill impact ("TBI") issue.

5. The second, and related, issue is the weight which the Board should place on HON's failure to make material reductions, of its own accord, in its revenue requirement, in order to reduce the impact on consumers.

6. The third is whether, or to what extent, the Board should approve forecast spending which is not directed or controlled by HON, and for which HON cannot provide evidence of prudence.

A. The TBI Issue

7. The context for the consideration of the TBI Issue is established by the decision of the Court of Appeal for Ontario in the case of *Toronto Hydro-Electric System Limited v. Ontario Energy Board* the "**THESL Decision**").

8. In the THESL Decision, the Court of Appeal made the following observation:

> The principles that govern a regulated utility that operates as a monopoly differ from those that apply to private sector companies, which operate in a competitive market. The directors and officers of unregulated companies have a fiduciary obligation to act in the best interests of the company (which is often interpreted to mean in the best interests of the shareholders) <u>while a regulated utility must operate in a manner that balances the interests of the utility's shareholders against those of its ratepayers. If a utility fails to operate in this way, it is incumbent on the OEB to intervene in order to strike this balance and protect the interests of the ratepayers</u>. (Emphasis added.)
>
> **(*Toronto Hydro-Electric System Limited v. Ontario Energy Board*, 2010 ONCA 284, para 50)**

9. It is acknowledged that HON's application is being considered in a time of continuing economic slowdown in the Province of Ontario and of rapidly rising electricity prices. The increases in electricity prices are attributable to a number of factors, only one of which is HON's Transmission rates. The factors include, but are not limited to, the costs of the smart meter initiative, the costs of creating a "smart" grid, the costs of renewable energy supply contracts, the costs of connecting renewable generation sources to the transmission and distribution system across the province, and the cost of replacing aging infrastructure. This increase in costs occurs, paradoxically, at a time of oversupply of electricity and reduced demand which would, in the ordinary course, have led to lower commodity prices.[1]

10. The Board has already recognized that it, and by necessary implication, distribution and transmission companies, must consider the TBI when setting rates. In its *Decision With Reasons* in EB-2009-0096, the Board made the following statement:

> Fourth, the Board must take into account the overall increase and prospect of further increases in the commodity portion of the bill. While these charges are outside of the control of the applicant, they are no less real for customers. In giving effect to the Board's objective to protect the interests of consumers the Board cannot ignore the overall impacts on customers.

***Decision With Reasons* EB-2009-0096, page 13**

11. That the Board must have regard to the TBI is reinforced by the circumstances of HON's application. The Minister of Energy wrote to HON asking it, in the context of the economic conditions in the province, to reassess its application in order to mitigate rate pressures. (**Ex. I/T1/S98, Attachment 2**)

12. The question, then, becomes what criteria the Board should apply to HON's application to give effect to the TBI. One consideration is whether, or to what extent, HON took TBI into consideration in developing its application, and made material reductions in its revenue requirement to reflect that.

[1] The unchallenged evidence of Mr. Sharp estimates that the total bill increase, for a residential consumer, between 2010 and 2014, may be as high as 47%. (**Ex. M2**)

B. The Effect of HON's Failure to Make Material Reductions, Of Its Own Accord, In Its Revenue Requirement

13. As noted above, the Minister of Energy wrote to HON, by letter dated May 5, 2010, asking that it reassess its application in order to mitigate rate impacts. The Board's role is not to penalize HON for failing to respond adequately or appropriately to the Minister's letter. Rather, the Minister's letter highlights the question of whether HON has fulfilled the obligation, confirmed by the Ontario Court of Appeal in the THESL Decision, to balance the interests of its shareholder and its ratepayers.

14. In its November, 2009, presentation to its Board of Directors, HON's management sought approval of an application which would result in Transmission rate increases of 26% in 2011 and 11% in 2012. (**Ex. KX 1.3)**

15. In a Memorandum to the Board of Directors, dated February 11, 2010, the proposed increase in Transmission rates had been reduced to 16.2% in 2011 and 9.8% in 2012 (**Ex. KX 1.4**)

16. The reduction in the Transmission rate increase, between November of 2009 and February of 2010, was due principally to the deferral of Green Energy Plan ("GEP") projects. The February 11, 2010 Memorandum contains the following statement:

> Hydro One's revised application reflects a reduction in rate base from levels initially proposed for both 2011 and 2012; however, the nature of the reductions or deferrals does not materially increase the risk to the Company. These reductions largely reflect Green Energy Project deferrals pending confirmation by the OPA that there is sufficient demand to proceed with the projects or deferrals as a result of delays in customer requests. Reductions in Transportation and Work Equipment and delays in bringing on additional resources are a direct result of these project delays.
> (**Ex. KX 1.4, p. 3**)

17. It is important to note that these reductions did not result from decisions by HON's Board or its management. The reductions flowed from the Minister's decision to ask the OPA to review demand and supply options.

18. The reductions were offset by the happy coincidence of a Broad-mandated increase in HON's ROE. This was evident from the February 11, 2010, Memorandum, and was confirmed in the following exchange with by Mr. Gregg, in cross-examination:

> MR. GREGG: If we go to the second paragraph, second sentence, I will read it to you.
>
> > "On December 11, 2009 the OEB issued its cost of capital report which reset the formula for determining return on equity and established an initial rate of 9.75 for 2010."
>
> That, sir, is the main driver for the rate decrease between November 2009 and February 2010.
>
> MR. WARREN: Okay. May I assume, Mr. Gregg, that the primary driver, then, for the decrease was that you anticipated getting an increase in revenue from the increased return on equity resulting from the Board's cost of capital position; is that a fair conclusion on my part?
>
> MR. GREGG: Yes, that's correct. (**Tr., Vol. 2, p. 92**)

19. In a Memorandum to the Board of Directors on May 13, 2010, HON's management included the following statement:

> A careful review of the Transmission costs and given the customer impact of rate increases, Hydro One has revised its 2011-2012 application. The Transmission business revenue requirement for 2011 has been reduced by 57 million. It is now 1.445 billion, and 2012 has been reduced by 65 million and is now 1.547 million (sic).

The resulting increase in Transmission rates would be 15.7 percent versus 21.5 percent in 2011, and 9.8 percent in 2012 versus 9.1 percent. (**Ex. I/T3/S1**)

20. It is HON's position that the reduction in the revenue requirement was a result of two factors. The first was an effort, undertaken in March of 2009, to reduce the revenue requirement in response to the Minister's concern about the impact on ratepayers. (**Tr., Vol. 5, p. 131**) The second was HON's attempt to comply with the Decision of the Board in EB-2009-0096, which was released on April 9, 2010. (**Tr., Vol. 5, p. 132**)

21. There is no evidence in the materials HON filed in support of its application to support its assertions that reductions in revenue requirement were made of its own volition to protect the interests of consumers. The question was put, first, to Mr. Gregg, in the following exchange:

> MR. WARREN: Now, can you tell me this? In deciding what rate increase to seek, does Hydro One Networks take into consideration other factors, for example, a global adjustment, in terms of its impact on ratepayers?
>
> MR. GREGG: It would be part of the overall consideration, part of the discussion, yes.
>
> MR. WARREN: Can you tell me where, in the materials that are before the Board in this application, there is an indication of how Hydro One Networks' board or its management considered these other factors like the global adjustment? Is there anywhere in the material we have in this application which tells us how those factors were considered?
>
> MR. GREGG: Not that I can readily point to. (**Tr., Vol. 2, p. 108**)

22. The same question was put to Mr. Struthers, in the following exchange:

> MR. WARREN: Okay. And may I assume that one of the drivers - there are too many negatives in this, and I apologize - that one of the drivers in this was not a concern about the impact of the application or the revenue requirement on ratepayers? Is that fair on my part?
>
> MR. STRUTHERS: No, it is not fair.
>
> MR. WARREN: But it is not mentioned anywhere in this document, is it, Mr. Struthers?
>
> MR. STRUTHERS: Without going through every line on the document, I believe, subject to check, I believe you are probably correct. (**Tr., Vol. 6, p. 25**)

23. That HON does not in fact look to the impact of its Transmission rates on the electricity prices paid by its consumers is confirmed by the following comment by Mr. Struthers:

> I would have to look at the Energy Board, the Ontario Power Authority and the Minister of Energy as being the organizations that would have some perspective around the strategy for electricity rates in Ontario. (**Tr., Vol. 6, p. 61**)

24. The reductions in the revenue requirement, reflected in the May 13, 2010 Memorandum, were principally a result of the following factors:

1. HON's response to the requirements of the Board's Decision in EB-2009-0096. That resulted in a $6.5 million reduction in OM&A; (**Tr., Vol. 6, p. 37**)

2. Reductions in capital that were almost entirely a result of the Minister's request to delay the implementation of most of HON's green energy projects. (**Ex. KX 1.4**)

25. HON claims that there were reductions in the revenue requirement that resulted from the Minister's request to reassess the application in light of the potential impact on ratepayers. The first was a reduction of $13 million in OM&A. The second was a reduction of $1 million attributable to shared services. **(Ex. J2.2; Tr., Vol. 6, p. 22 ff.)**

26. The reduction of $13 million has to be seen in the context of HON's overall OM&A spending. The forecast OM&A spending in 2011 is $436 million. HON's reduction in its OM&A spending, to reduce the impact on ratepayers, is thus approximately 2%.

27. HON did not consider reducing its allowed return, in order to, in turn, reduce the impact on ratepayers. The issue was raised with Mr. Struthers in the following exchange on the issue:

> MR. STRUTHERS: Are you asking me whether the board of directors of Hydro One raised the issue? Is that the question?
>
> MR. THOMPSON: Yes.
>
> MR. STRUTHERS: I am not -- not that I am aware of, no. In the discussions, no, not that I'm aware of. (**Tr., Vol. 6, p. 93**)

28. HON's unwillingness to consider a reduction in the return to its shareholder takes on a particular significance in light of a submission in its Argument-in-Chief. Counsel for HON, in opposing the suggestion that the return be reduced to offset customer impacts, made the following submission:

> The profits earned by the company through its allowed rate of return are, ultimately, paid to the province and are used to support a host of social programs, such as, for example, our school system.

> If we are to reduce the allowed return because of customer impacts, this implicitly means that the taxpayers of Ontario will be subsidizing the electricity users of Ontario. (**Tr., Vol. 11, p. 16**)

29. The Board should draw at least three conclusions from these astonishing admissions. The first is that they confirm that HON does not need its requested level of ROE for commercial reasons. Mr. Struthers had in effect acknowledged that when he agreed that HON does not raise equity in the capital markets. (**Tr., Vol. 6, p. 94**) The ROE, as the passage from the Argument-in-Chief demonstrates, provides the shareholder with a source of funds that could, and should, come from taxpayers.

30. The second is that HON could reduce its ROE without compromising the safety or reliability of its system.

31. The third is that it is an implicit recognition that HON has chosen to prefer the interests of its shareholder over that of its ratepayers, something which the Court of Appeal has said it cannot do. It also is an attempt to introduce, into a rate hearing, considerations which should apply to the legislature's considerations of tax and social policies.

32. The Council submits that the Board should draw the following conclusions about HON's ostensible efforts to reduce its revenue requirement to reduce the impact on consumers. The first is that HON's management and its Board made no effort on their own to make any cost reductions. Reductions were only made as a result of the Decision of the Board in EB-2009-0096, the decision of the Minister and the OPA to defer the green energy projects, and the request of the Minister to make reductions in the revenue requirement.

33. The second is that the cuts were, in fact, *de minimus*. The cuts in OM&A form a tiny fraction of overall OM&A spending. The cuts in capital spending are, in reality, merely deferrals, pending further direction on green energy projects.

34. The Council submits that the Board should conclude that HON has failed to fulfil the obligation, most recently expressed by the Court of Appeal in the THESL decision, balance the interests of its shareholder and the interests of its ratepayers.

35. Accordingly, when the Board is looking at the application as a whole, it should do so in the context of HON's failure to fulfil its obligation. It falls to the Board to fulfil that obligation, and to properly balance the interests of HON's shareholder and its ratepayers. .

C. Projects Which HON Does Not Direct and Control, And For Which It Offers No Evidence of Prudence

36. The third general issue is how the Board should deal with projects, and related spending, which are not directed and controlled by HON, and for which it can offer no evidence of prudence. This general issue is particularly relevant to the consideration of HON's GEP. However, consideration of the issue requires a principled approach to the entire application.

37. It is clear, from the testimony of HON's witnesses, that it does not direct or control, in anything other than a purely mechanical sense, its green energy projects.

38. To begin with, the projects which form, for all intents and purposes, the entirety of its GEP, are those set out in the two schedules to the Minister's letter, to HON, of September 21, 2009. With the exception of some of the projects on Schedule B to the Minister's letter of September 21, 2009, HON did not begin development work on what is now the core of its GEP until told to do so by the Minister. It is also clear, from the evidence, that HON did not consider whether the projects were prudent.

39. In its pre-filed evidence, HON made the following assertion about the green energy projects:

> The vast majority of potential renewable generation is remote from
> the Transmission grid and/or the Province's load centres.
> (**Ex. A/T11/S4, p. 3**)

40. The implications of that statement were explored, with Mr. Gregg, in the following exchange:

> MR. WARREN: At the crude level of understanding at which I am comfortable operating, when I see that there is a remoteness factor, that suggests to me that there would be, in the ordinary course, some risk in Hydro One Networks building a Transmission line to a remote generation source. Is that a fair understanding on my part?

> MR. GREGG: When you look at large-scale capital-intensive projects of that nature, yes, there are risks that go along with those.
>
> MR. WARREN: And in the ordinary course, where there is a risk identified by Hydro One, there would be some form of cost benefit analysis so that you could come, for example, to this Board and say that the benefits of building this Transmission line outweigh the costs and the risks. In the ordinary course that would be the case; is that fair, Mr. Gregg?
>
> MR. GREGG: That would be fair. (**Tr., Vol. 2, p. 120**)

41. Notwithstanding that, HON, when asked whether it was aware of cost-benefit analyses for these projects (the green energy projects) prepared by the Ministry, the OPA or third parties, HON responded that: "Hydro One has not performed, nor is it aware of any cost/benefit analyses of the projects contained in the GEP." (**Ex. I/T10/S38)**

42. Hydro One's identification of green energy projects is based on direction from the government, and the OPA's identification of need. In its pre-filed evidence, under the heading "Determining the Need for Green Energy Projects", Hydro One makes the following assertion:

> Hydro One's plans for new GE projects will be based on the OPA's identification of need or direction from the government. (**Ex A/T11/S4, p. 3**)

43. Hydro One was asked about the planning criteria, for its green energy projects, in the following exchange:

> MR. WARREN: Absolutely, sir. The minister tells you what to do and you do it; correct?
>
> MR. GREGG: If we are directed under our memorandum of agreement with our shareholder, the minister has the power to direct us to do certain things, yes.
>
> MR. WARREN: And am I right that the OPA performs the so-called TAT and ECT tests?
>
> MR. GREGG: They have performed the TAT, and they're planning to perform the ETC.
>
> MR. WARREN: Hydro One Networks doesn't perform either one of those tests; correct?
>
> MR. GREGG: No, no. OPA does that.

> MR. WARREN: And Hydro One Networks, as the evidence indicates, performs no cost benefit analysis on the green energy projects; correct?
>
> MR. GREGG: We have not yet.
>
> MR. WARREN: Okay. Hydro One Networks builds Transmission lines essentially where the minister tells it to based on, in part, what the OPA does with its TAT and ECT tests; is that correct?
>
> MR. GREGG: Yes. I think the point there is to begin development work. You have to remember that all of these projects would be subject to a section 92 approval.
>
> …..
>
> MR. WARREN: All I want to know is, whether you or Mr. Young, am I missing any of the planning criteria that you use for your green energy projects as we sit here today, other than the ones I have read to you?
>
> MR. YOUNG: From the perspective of development work, and to initiate that development work, those are the primary triggers. (**Tr., Vol. 2, pp 123-125**)

44. That HON is dependent on direction from others, for its green energy projects, was confirmed by Mr. Struthers, in the following exchange:

> MR. WARREN: Is it your expectation that the Ontario Energy Board would tell you to proceed with a green energy project?
>
> MR. STRUTHERS: It is not my expectation at all. I am sure that we will be directed by some party, a third party, and we will take direction as appropriate.
>
> MR. WARREN: One way or another, it isn't your choice to proceed with those green energy projects. Somebody else tells you to do it. Have I understood that?
>
> MR. STRUTHERS: Yes, that is correct. (**Tr., Vol. 6, p. 20**)

45. Having depended on the Minister's direction to begin development work on the core of its GEP, HON then stopped development work as a result of yet another letter from the Minister, this time to the OPA. (**Ex. I/T1/S98, Attachment 1**)

46. HON does assert that, while the OPA can recommend that HON proceeds with a project, the decision whether to seek Board approval for expenditures is HON's. (**Ex I/T10/S27**) With respect, this faint assertion of seeming autonomy is at odds with the overwhelming

preponderance of evidence that the Minister and the OPA direct all of HON's GEP projects, and the evidence that HON conducts no cost/benefit analysis on them.

47. Notwithstanding that HON does not initiate its green energy projects, and undertakes no cost-benefit analyses as to whether the projects themselves are prudent, it is asking the Board to recover some of the costs of those projects. The details of what HON is seeking, and the Council's submissions as to what the Board's response ought to be, are dealt with below. The larger question, at this point, is whether the Board should approve the recovery of costs for any project which HON does not control and for which there is no evidence, from HON, that the projects are prudent.

48. The issue arises, in the first instance, from the fractured responsibility for decision-making created by recent changes to the *Ontario Energy Board Act* (the "OEB Act") and the resulting overlapping roles of decision-makers. The imperatives for a GEP were created by the government through legislation. The Minister, in his capacity as the representative of the shareholder, provided, in the September 21, 2009, the direction to HON to begin development work on the green energy projects. It should be noted that the Minister's direction should be given no greater weight than should the direction of any other shareholder. The projects are to provide Transmission links to green energy supply sources. The sources of supply have been approved by the OPA. HON has no role in the decision about whether the supply is required, whether the particular renewable energy source is a reasonable one, and, therefore, whether the overall Transmission link is prudent.

49. The Council submits that the Board should not approve projects for which HON cannot provide evidence of prudence.

50. The Council acknowledges that this may create an apparent conflict, for the Board, given the various legislative imperatives. These legislative imperatives have limited relevance, in this case, in light of the Minister's decision to put the green energy projects on hold. However, the overriding obligation of the Board is to approve just and reasonable rates, pursuant to section 78 of the OEB Act. The Board cannot, and should not, do that in circumstances where HON can provide no evidence of the prudence of the overall project.

51. What, then, are the implications of these three issues for the Board's consideration of HON's application? The Council submits they are the following:

1. the Board should find that HON has failed to fulfill its obligation to balance the interests of its shareholder and that of its ratepayers;

2. given HON's failure to balance the interests of its shareholder and its ratepayers, the Board is obligated to do so;

3. in order to strike the appropriate balance, the Board should further reduce HON's revenue requirement, as specified in various sections below, to insure that the TBI is minimized to the extent possible;

4. the Board should not approve those projects, and the cost consequences of those projects, which HON does not direct and for which HON has not provided its own, independent evidence of prudence.

II ISSUES

ISSUE 2 LOAD FORECAST

2.1 CDM ADJUSTMENT

52. HON develops it charge determinants from its forecast of Ontario peak demand. As a part of its forecasting model it makes an adjustment for conservation and demand management ("CDM") impacts. In its final argument the Vulnerable Energy Consumers Coalition ("VECC") has made submissions on HON's CDM adjustment. Specifically VECC argues that HON has overstated the impacts of CDM in it forecast. VECC relies on the fact that HON has not used the most recent revised provincial conservation projections developed by the OPA. The Council supports the submissions of VECC on this issue and the adjustments proposed. It is critical that HON use, in the development of its load forecast, the best available information regarding the impact of CDM programs. As noted by VECC, that information has been provided by the OPA to HON. To the extent HON overstates the expected results, the rates will be higher.

2.2 RATES FOR EXPORT TRANSMISSION SERVICE

53. As part of the Settlement Agreement approved by the Board in EB-2006-0501 it was agreed that the Independent Electricity System Operator ("IESO") would conduct a study of alternative Export Transmission Service ("ETS") tariffs. That study was completed and filed with the Board on August 28, 2009. By letter dated October 6, 2009 the Board directed that the issue of ETS tariffs be considered in the 2011-2012 Transmission Rate proceeding.

54. The current ETS tariff has been set at $1/MWh and has not changed since 1999. HON's export tariff revenues are based on that rate and a forecast of the volume of electricity exported from or wheeled through Ontario over the Transmission system. The $1/MWh was considered by the Board to be a "reasonable compromise between many of the competing interests and proposals that were advanced in the hearing". In addition, it was considered to be an "interim" solution. Concerns were raised by parties to that hearing about what would be an appropriate charge to help defray the costs of the Transmission system for domestic customers for the use of the network Transmission system. Other issues that were debated included the potential impacts of the tariff on international trade, the development of open and efficient regional markets as well as the potential environmental consequences from higher exports that may be influenced by the tariff level. (**Ex. H1/T5/S2, p. 1**)

55. The IESO tariff study considered four options for tariff design:

- Option 1 - Status Quo with the tariff remaining at $1/MWh;
- Option 2 - Equivalent Average Network Charge - Export and wheel-through transactions would pay a rate equivalent to the average Network Transmission Service cost, using energy as the charge determinant;
- Option 3 - Reciprocal Treatment of ETS charge;
- Option 4 - Unilateral Elimination of the ETS tariff - within this option two alternatives were considered - unilateral elimination in all hors and unilateral elimination of the tariff only during off-peak hours.

56. Option 2 was, from the IESO's perspective, the option that best satisfied the principles of simplicity of implementation, consistency with rates in neighbouring markets, fair

and equitable, and the one that would provide Ontario with a net benefit, principally through the shifting of a portion of Transmission network cost recovery from the domestic consumer to the exporting parties. (**Ex. H1/T5/S2/Attachment 1, p. 9**) Although Option 2 was considered by the IESO to be the best option for Ontario, it recommended that the status quo be maintained.

57. The IESO indicated that since undertaking the study a number of factors have changed significantly. These include load deterioration due to economic conditions, legislative changes through the *Green Energy Act* ("GEA"), and increased occurrences of surplus baseload generation ("SBG"). From the IESO's perspective a recommendation that would place downward pressure on exports is not considered appropriate or consistent in the context of lower demands and an increase in renewable generation. It concluded that the magnitude of the net Ontario benefits observed in Option 2 are relatively small when compared with the overall Ontario transactional costs and may well be further degraded as a result of changing conditions. (**Ex. H1/T5/S2 Attachment 1, p. 9**)

58. The Board, at the time it set the initial tariff, characterized it as transitional or interim. The IESO undertook a comprehensive study based on quantitative analysis followed by a stakeholder consultation process, all of which pointed to Option 2 as the right choice for Ontario. The IESO is now claiming that to move to Option 2 would not be appropriate. That recommendation is not based on any further quantitative analysis. There has been no evidence provided that a change in the ETS tariff would compromise the Ontario market. Although an incremental benefit to Ontario would arise under Option 2, it is the IESO's position now that the benefit is not sufficiently material to warrant a change to the ETS tariff. That view is not supported by a quantitative study.

59. The Board has been provided with an overwhelming case that a change in the ETS would be appropriate. The Council submits that, in the absence of new quantitative evidence to the contrary, a change in the ETS tariff is warranted. The point is to help Ontario consumers defray the cost of the Transmission system and ensure that generators that export or wheel through Ontario contribute to the costs of the system that they are using. The Council submits that the ETS be increased to $2/MWh for 2011 and 2012. The increase will provide an incremental benefit to Ontario consumers through increased revenues. In addition, it will

provide the IESO some time to monitor the impacts of the change on the market. Furthermore, the Council submits that the IESO should be required to submit, for HON's next Transmission rate proceeding, a quantitative study that considers the various alternatives for change and the costs and benefits associated with those options, given the recent changes in the Ontario electricity sector including SBG.

Export Revenues

60. In calculating the overall revenue requirement HON includes an export revenue credit. That credit relates to the revenue HON receives from the IESO from the ETS tariff. In 2011 the amount is $10.1 million and in 2012 the amount is $10.2 million. In 2010 the forecast was $12 million. In each year since 2005 the revenues associated with the ETS tariff have been above the forecast levels. (**Ex. I/T9/S1 p. 3**) In the last proceeding the Board approved variance account on the basis that the revenue levels are beyond the control of HON. HON, in this proceeding is proposing that the account be discontinued given it has sufficient history to establish a valid forecast. (**Ex. I/T6/S11**)

61. The Council agrees that the revenues are beyond the control of HON and, as the Board noted in the last proceeding, there is no way to create an incentive for HON to increase these revenues. (***Decision with Reasons,*** **EB-2008-0272, p. 12**) Accordingly, the Council supports the continuation of the deferral account so that both HON and its customers are kept whole. HON has not in our view presented sufficient evidence to eliminate the account.

ISSUE 3: OPERATIONS, MAINTENANCE AND ADMINISTRATION COSTS

62. For 2011 HON is proposing to spend $436.3 million in OM&A. For 2012 the overall amount represents a 3.1 % increase, resulting in a budget amount of $450 million. The 2010 Board approved amount was $426.2 million. In addition, HON is proposing to spend an additional amount of $132.7 million on GEP projects that is to be captured in a deferral account for future recovery. (**Ex. C1/T2/S1 p. 3**) For each of the two test years HON made reductions of approximately $20 million prior to the filing of its application.

63. The Council submits that HON's OM&A budgets should be reduced further, for a number of reasons. The first is that HON's evidence is that it will not be pursuing its GEP

projects at the same pace and capacity that it had originally intended to do. This is in large part because of the recent direction from the Minister of Energy to effectively step back and rethink many of the projects HON was directed to do by the previous Minister. Many of the proposed OM&A cost increases have been driven by the implementation of the GEA and HON's GEP.

64. Another compelling reason for a reduction on HON's overall OM&A levels is the ongoing concern expressed by the Board and intervenors about compensation levels. The Board made an OM&A reduction in the 2009-2010 Transmission proceeding to reflect this concern. In addition, the Board made a reduction to HON's OM&A levels in the 2010-2011 Distribution rate proceeding. The issues regarding compensation need to be addressed again by the Board as HON's compensation levels remain high relative to comparators, voluntary terminations remain low, and HON continues to significantly increase its staffing levels. In addition, since the time the original budget was developed, the pace at which staff will be required for project development has changed.

Compensation/Human Resource Costs

65. HON has a separate revenue requirement and rates for both its Transmission operations and its Distribution operations. Despite the separate revenue requirements the company operates as an integrated company. Compensation levels are essentially the same for both components of the business. The issue of compensation has been considered in HON's last Transmission rates proceeding and in HON's last Distribution proceeding for the years 2010 and 2011.

66. In the last Transmission proceeding HON filed a compensation and productivity study prepared by Mercer Canada Limited and Oliver Wyman ("Mercer Study"). The compensation portion of the study concluded that on a weighted average basis, for the positions reviewed, HON's compensation was approximately 17% above the market median. HON's response to the study was that its compensation levels are driven by legacy collective bargaining agreements, legacy pension and benefit programs and the need for competitive salaries. (***Decision with Reasons*, EB-2008-0272, pp. 25-26**) HON further added that its higher compensation levels are acceptable because of its higher productivity. (***Decision with Reasons*, EB-2008-0272, p. 28**) The Board did not accept that the productivity portion of the Mercer

Study could be relied on. Accordingly, the Board made the following comments regarding compensation:

> Hydro One's evidence is that the revenue requirement would be $13 million less if it were based on the median compensation level from the Mercer Study. Some parties suggested that this amount should be disallowed. The Board does not believe that a reduction of that magnitude is warranted; such a disallowance would imply that the Mercer Study was precise and/or that there were no mitigating circumstances. 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. This disallowance is separate from, and additional to, any labour cost reduction that results from the disallowance of sustaining maintenance program costs made earlier in this Decision as well as any labour cost reductions that result from the Board's findings related to certain Development Capital projects covered in the Capital Expenditures section of this Decision. (***Decision with Reasons*, EB-2008-0272, p. 31**)

67. The Board again addressed compensation in HON's most recent Distribution rate proceeding. The Board made the following findings, having referred to its conclusions in the Transmission case:

> The Board concludes that a comparable reduction is warranted for the Distribution business. Hydro One has shown (for the categories presented) that it had controlled wage escalation better than some of the other Ontario Hydro successor companies. However, compensation costs remain excessive in comparison to market indicators. The evidence indicates that Hydro One's main competition for labour comes from within Ontario and the Board regulates most of those entities. It would be unacceptable for the Board to, in effect fuel that wage competition by incorporating ever rising wage levels (over and above market related levels) into rates. Hydro One indicated that a reduction of $9 million would be comparable to the Board's finding in the Transmission decision. The Board has already established an overall OM&A envelope and will not order this specific reduction. However, the Board would observe that compensation costs, including growth in headcount, are one of the areas in which Hydro One must take further action to control expenditure increases. (***Decision with Reasons*, EB-2009-0096, p. 18**)

68. In this proceeding HON has maintained that the results of the Mercer Study presented in the previous Transmission and Distribution cases are still valid. (**Tr., Vol. 5, pp. 186-18**7) The Board made adjustments based on the Mercer study in those two cases. Although the reduction in the Distribution case was part of an overall envelope reduction for the 2010 and 2011 test years the Board expressly commented on the need for HON to control compensation-related expenses. As noted above, HON is an integrated company. If the Board expressed concern about compensation as it relates to the 2011 Distribution business, the same concerns are relevant for the 2011 Transmission business. In effect, it is the same company with the same employees.

69. HON has continually made the claim that it is effectively restricted in terms of compensation adjustments because 90% of its employees are subject to collective bargaining agreements. Although embedded in the revenue requirement is an assumption that Power Workers Union ("PWU") wages increase in 2011 by 3% the current agreement with the PWU expires in March 2011. (**Tr., Vol. 5, p. 193**) Actual compensation will depend upon the outcome of the collective bargaining process. Given the Ontario Government's "net zero" policy with respect to compensation increases the Council submits that the 3% assumption for PWU compensation may well be too high. Although the revenue requirement has been adjusted to reflect the net zero policy as it pertains to management, it has not been applied in the context of the PWU or the Society of Energy Professionals. (**Tr., Vol. 5, pp. 192-193**)

70. Another factor that should lead to a reduction in compensation is the extent to which HON's attrition levels are low. HON has repeatedly discussed, in this case and previous cases, the extent to which its greatest "corporate risk with respect to human resources continues to be an aging workforce". HON points to a study that indicates that the line of business that will be most affected by retirements is Transmission. (**Ex. C1/T3/S1/p. 1**) HON's evidence is that by December 31, 2009, approximately 1000 Networks staff (Distribution and Transmission) were eligible for an undiscounted retirement. Of those, 111 actually retired. (**Ex. I/T10/S22**) This "factor" forms part of HON's rationale that compensation costs are increasing as it dictates a need for training and apprenticeship programs. Despite their claims, the actual attrition rates have been very low for Management Compensation Plan staff as well with only 6 of 609 employees opting for voluntary termination. (**Ex. I/T2/S49**)

71. In its evidence HON points to the fact that it compensation levels will impacted by the fact that significant electricity Transmission and Distribution facilities will be needed as a result of the following:

- The promulgation of the Government's GEA in May 2009;
- The Government's announcement with respect to the shut-down of two coal fired generating units at Lambton and tow units at Nanticoke in 2010 in advance of the shut-down of all coal fired generation by 2014;
- The indefinite delay in the in-service date of new nuclear generation, previously assumed to be 2018 in the IPSP;
- The September 21, 2009, direction letter from the Minister of Energy and Infrastructure to HON to undertake a program of expansion and renewal of the Transmission and Distribution systems over the next three years and beyond, with the objective of maximizing opportunities to harvest renewable energy in the Province. (**Ex. C1/T3/S1 p. 2**)

72. HON notes with respect to its staff planning:

> Progress has been made in attaining the optimal number and mix of staff required to complete the Company's increasing work programs. However, the increases in some of Hydro One's Transmission and Distribution programs will add additional challenges, given the tight competition for labour and power system professionals. It is essential because of long learning curves required for competent performance of our highly skilled jobs that we hire well in advance of the requirement.
> (**Ex. C1/T3/S1, p. 4**)

73. HON's budget was put together in response to the requirements of the GEA and the Minister's September 21, 2009 letter. Given the changes that have taken place since then, and the more recent letter from Minister Duguid, HON's compensation budget as filed can and should be reduced. The projects originally anticipated at the time the budget was set will not be advancing at the pace originally expected.

74. Overall the Council submits that at a reduction in compensation costs is justified. For all of the reasons set out above, HON should be able to function during 2011 and 2012 with a significantly lower compensation budget. In addition, nothing has effectively changed since

the Board made the adjustment in the 2009-2010 Transmission proceeding and the adjustment in the 2010-2011 Distribution cases. HON's compensation remains 17% above the median level for comparables. As noted above, these are the same employees within the same organization. The Council supports a reduction that would essentially be comparable to the reduction made in the last Transmission proceeding, $6.2 million for 2011 and $6.9 million for 2012 plus a further reduction, set out below, to address the additional concerns we have raised.

Development OM&A

75. Development OM&A provides the funding for the following key areas

- Research, Development and Demonstration;
- Standards Development;
- Smart Zone Development
- Development Work for Major Transmission Projects.

76. For 2011 HON has a budget of $6.4 million for Research, Development and Demonstration ("RD&D"). For 2012 the budget is $6.6 million. The RD&D budget is for testing the feasibility of emerging technologies. It involves pilot and demonstration projects and partnerships with Universities etc. Under cross-examination HON admitted that these expenditures are set out at a high level with no definitive project by project analysis. (**Tr., Vol. 2, pp. 129-131**) In addition , HON has a budget for Smart Grid Development, but has not provided any details for the $4 million budget for 2011 and 2012. Mr. Bing admitted that there is nothing on the record in this case which provides a business case analysis for these projects. (**Tr., Vol. 2, p. 131**)

77. The Council submits that HON has not provided sufficient evidence to support $10.4 million in 2011 and $10.6 million in 2012. For RD&D HON has simply escalated the 2010 budget. No specific projects or the associated project costs have been defined. For Smart Zone Development HON has budgeted $4 million in each year. The Council submits that in the interests of cost containment, and in the absence of any business case analysis, these budgets

should not be approved. If HON feels that spending in these categories is necessary, it can and should find the funds elsewhere in its budget.

Common Corporate Functions and Services

78. Common Corporate Functions and Services ("CCF&S") include Corporate Management, Finance, Human Resources, Corporate Communications and Service, Legal, Regulatory Affairs, Corporate Security, Internal Audit and Real Estate. Overall CCF&S costs are $79.7 million for 2011 and $86.6 million for 2012. These represent the amounts allocated to Transmission, as CCF&S costs are shared between the two network business units. In its evidence HON indicated that one of the drivers for increases in these costs is increased workload related to the GEA. (**Ex. C1/T2/S7 p. 2**) HON's evidence is that total CCF&S costs increase by $7 million due to new cost recovery charges from the NEB, increased OEB fees and higher Corporate Communications costs for coordination of the development and partnership activities of each of HON's major GEA projects.

79. The specific cost components within the CCF&S that have budget increases driven by the GEA are General Counsel and Secretariat and Corporate Communications. Corporate Communications is increasing by $5 million because of the following:

> coordination of development and partnership activities; coordination with external energy agencies (e.g.- OPA, IESO); Ministries in the Ontario Public Service and internal Hydro One resources regarding major grid projects and initiatives; preparation of risk assessments related to project development phases of Green Energy Projects; provision of strategic direction regarding the scope and timing of project development work; participation in pre-public consultations with municipalities and First Nations; representation of Hydro One on external working groups; development and negotiation of partnership arrangements for major GEGEA investments to support corporate strategy and government objectives. (**Ex. C1/T7/p. 13**)

80. With respect to General Counsel and Corporate Secretariat the evidence indicates that the increase in costs in 2011 as compared to 2009 is driven mainly by the work requirements related to the GEA and Records Management project. (**Ex. C1/T2/S7**) Specifically, examples of the additional workload include, more procurement work related to the larger work program,

review of legal agreements associated with distributed generation and real estate related to legal work to obtain land rights for new development projects.

81. The Council submits that it is only logical that if HON's activities relate to the GEA and its own GEP are slowing down relative to what was anticipated when the original business plan was developed, these budgets should be reduced by 50%.

Harmonized Sales Tax

82. HON has indicated that, with respect to the Harmonized Sales Tax ("HST"), the forecast reduction in OM&A for 2011 will be $5.2 million and $5.3 million in 2012. (**Ex. I/T1/S91**) HON is proposing that these reductions be excluded from the revenue requirement and instead captures in a deferral account. The Council submits that the reductions in the HST should be reflected in the revenue requirement.

Overall 2011 and 2012 OM&A Budget Reductions

83. The Council has proposed that HON's compensation costs for 2011 and 2012 be reduced to reflect the Mercer Study. The Mercer Study is still relevant from HON's perspective and was used by the Board in the last two proceedings to reduce HON's overall compensation. Those compensation levels have not been reduced since those previous decisions were rendered and have increased by annual inflators. The Council has other concerns with HON's compensation as well. HON has not reflected the Government's net zero policy in its revenue requirement except with respect to senior management. It would appear inconsistent for the Government to mandate such a policy for government agencies and ministries and not for its crowned owned corporations like HON. In addition, the need to significantly ramp up HON's hiring to meet new requirements has been dampened by two factors - the fact that voluntary terminations have not been, in practice, occurring at rates previously expected. There may be an increasing number of employees eligible, but the number of employees exercising the options has not been significant. In addition, the GEA and GEP "re-tooling" has meant that projects will not be moving ahead at the original pace expected when the business plan was developed.

84. With respect to other elements of OM&A , namely CCF&S, the Council has pointed to areas where cost increases have been driven by the GEA and HON's GEP. Given the

fact those projects will not be moving forward at the pace originally expected, the areas where those plans impact OM&A should see a corresponding decrease in activity.

85. The Council has also, within the area of Development OM&A, pointed to areas where the budgets are not supported by business plans. In the area of Research, Development and Demonstration, HON has large budgets for undefined projects. In the absence of solid business case analysis these budgets should be rejected. In addition, the Smart Zone amounts of $4 million in each year appear to be placeholders for yet undefined OM&A activity. Again, without a business case analysis those budgets should be rejected.

86. The Council's proposed reductions for OM&A are as follows:

	2011	2012
Compensation/Mercer	$6.2 m	$6.9 m
Other Compensation	$3.0 m	$3.0 m
Green Energy Reductions	$1.5 m	$1.5 m
RD&D (reduce by 1/2)	$3.2 m	$3.3 m
Smart Zone	$2.0 m	$2.0 m
HST	$5.2 m	$5.3 m
TOTAL:	**$21.1 m**	**$22.0 m**

ISSUE 6: DEFERRAL AND VARIANCE ACCOUNTS

87. HON is seeking approval to discontinue the following three variance accounts:

- Export Service Credit Revenue
- External Secondary Land Use Revenue
- External Station Maintenance and E&CS

88. The Council submits that, given the fact that the revenues associated with these accounts have been largely unpredictable and to a significant degree beyond the control of HON, these accounts should remain in place. Maintaining the accounts will ensure that the

actual revenues will flow to customers and that the amounts will not be subject to forecasting risk. In this context HON and it customers will be kept whole.

89. With respect to new accounts, the Council has no objection the establishment of the two proposed accounts that deal with International Financial Reporting Standards ("IFRS"). The first account is to record gains or losses on the disposition of assets. The second is to record the aggregate impact on the 2012 revenue requirement resulting from any changes to existing IFRS standards or changes in the interpretation of such standards. The account is identical to what was approved for HON Distribution in its 2010-2011 case and will allow HON to record, for future disposition, those revenue requirement impacts resulting from IFRS changes that arise before the next cost of service proceeding. (**Ex. F1/T1/S2/p. 2**) The Council notes that the establishment of the accounts will not prelude parties from considering, in HON's next case the prudence of the expenditures recorded in the accounts.

90. With respect to the OEB Cost Differential Account the Council agrees with the submissions of Board Staff that the account is not required given the costs are embedded in HON's proposed revenue requirement.

ISSUE 8: CHARGE DETERMINANTS - HIGH FIVE PROPOSAL

91. HON is proposing to maintain the network service charge determinant methodology approved in it last two Transmission rate proceedings. The charge determinant under the existing methodology is the higher of a customer's demand coincident with the monthly peak or 85% of the customer's non-coincident monthly demand between 7 am and 7 pm.

92. As set out in HON's evidence, the network charge determinant provides customers with time-of-use signals that encourage use of Transmission system outside the 7-7 period, for which no Transmission Network charges apply. It also encourages customers to avoid the monthly system peak potentially lowering their network charges . HON has noted that the Board, in previous decisions, recognized that the existing charge determinants methodology

represents a trade-off between the principles of cost causality, revenue and rate stability, efficiency and fairness. (**Ex. H1/T3/S1/p. 2**)

93. In HON ‘s 2007-2008 Transmission rate proceeding HON proposed to maintain the same charge determinant methodology that had been in place for a number of years. This proposal was made following a consultation process with it stakeholders where a number of alternative methodologies were considered. In that proceeding the Association of Major Power Consumers in Ontario (“AMPCO”) presented an alternative proposal. That proposal included the following components:

- Eliminate the second element of the current Network charge determinant (85% of the non-coincident peak demand);
- Work with the IESO, OPA and other stakeholders to define those peak demand months of the year that are concern to system planners, operators and HON is terms of system reliability, adequacy of supply and the need for future peaking supply;
- Develop an appropriate non-ratcheted charge determinant based on the identified peak months.

94. From AMPCO’s perspective the rationale for the change was that the current design constituted a barrier to demand response and the efficient use of the Transmission system. They asserted that their approach would increase demand response, which would be consistent with Ontario government policy and would reduce electricity costs for all Ontario consumers. (***Decision with Reasons*, EB-2006-0501, pp. 93-95**) HON and most intervenors opposed a change in methodology, given that AMPCO did not make a case that under its approach demand would shift significantly. In addition, as noted in the Decision, AMPCO provided no evidence that its proposal would lower commodity costs for the benefit of all electricity consumers even if it assumed that it would result in significant load shifting by large industrial consumers. (***Decision with Reasons*, EB-2006-0501, p. 96**)

95. The Board determined in that proceeding that HON should continue with the existing approach. It did not accept AMPCO’s recommendation that HON should be ordered to work with the IESO, OPA and other stakeholders to design a new method. The Board concluded

that it was not saying it would be impossible to improve upon the current methodology, nor that it was not open to considering changes. It noted, however, that parties that advocate such changes in how customers pay for Transmission service "need to submit a strong case for change, with detailed evidence and analyses showing why the status quo has undesirable effects and is appropriate. In the Board's view AMPCO did not put forward that case in this proceeding." (***Decision with Reasons*, EB-2006-0501, p. 98**)

96. The issue was revisited in the 2009-2010 Transmission rates proceeding. AMPCO presented what has come to be known as its "High 5 Proposal". Under AMPCO's proposal, a fixed monthly network charge would be calculated for each customer based on that customer's demand during the hour of peak demand during the 5 highest peak days of the previous year. AMPCO argued that the customer's network charge would remain the same for each month of the year, but the customer would have an incentive to shift usage away from the peaks in order to reduce the charge applicable for the following year. The benefits that would arise from its proposal would be the ability to defer or avoid Transmission system upgrades and reductions in commodity prices in the market at peak times. AMPCO had proposed that it be implemented in 2011 in order to allow HON to make the necessary changes and work with the IESO and the OPA where necessary. (***Decision with Reasons*, EB-2008-0272, pp. 64-65**)

97. Some intervenors supported AMPCO's proposal whereas others did not. Board Staff questioned whether the proposal would lead to real incremental load shifting given the already existing commodity price signals to shift load, the relatively small proportion network Transmission charges are of the total bill, and the fact that the OPA has existing demand response programs in place. Board Staff concluded that there needed to be a more thorough assessment of the cost shifting and rate impacts and more consultation with the IESO, OPA and other transmitters. The Council argued at that time it would be premature to implement the AMPCO proposal without a full consideration of the precise impact on all consumers and that if the Board saw merit in the approach HON should be directed to report on those impacts as part of its next application. (***Decision with Reasons*, EB-2008-0272, p. 66**) VECC provided a critique of AMPCO's consultant's analysis concluding that there are uncertainties around the degree of load shifting and commodity price reductions that will occur and that by focusing on the five peak days the proposal would be inconsistent with current Transmission cost drivers and

generally accepted principles for establishing fair rates. (**p. 67**) HON echoed a number of the points made by VECC regarding the analysis provided by AMPCO's consultant.

98. In its argument the Electricity Distributors Association raised a number of valid concerns with the proposal:

- The proposal would have limited impact on the system because LDC load drives system peak, LDCs have limited ability to peak shift and Distribution rates are not based on Transmission system peaks;

- The current rate design does encourage conservation and ensures that customers share in the embedded cost of the system;

- The benefits of the proposal are not proven. Only one customer testified that it would implement the costly peak-chasing program. Most customers will shift in direct response to peak commodity prices providing a free ride for Transmission benefits under the proposal;

- The distributive impacts of the proposal are unknown. It is not certain that the customers that bear the costs of load shifting will also benefit from the claimed reductions in peak commodity costs. (**p. 67)**

99. In its Decision the Board agreed the proposal had merit but should not be implemented without further analysis. The Board noted that it did not accept that AMPCO's quantitative analysis represented a convincing assessment of the likely benefits of the rate design proposal. However, the Board did find that the evidence supported a conclusion that the proposed rate design would lead to some level of load shifting and some consequent impact on commodity prices. The Board questioned whether the level of shifting or the level of commodity savings would be as high as estimated by AMPCO. The Board did direct HON to come forward in its next application with further analysis of AMPCO's proposal and a suitable proposal for implementation if the Board accepted that a change was required. (***Decision with Reasons,* EB-2008-0272, p. 69**)

HON'S EVIDENCE

100. HON retained Power Advisory LLC "Power Advisory") to provide an analysis of AMPCO's proposal and specifically to perform an analysis of the costs and benefits of implementing the High 5 rate design including the potential load shifts in response to changes in prices (as represented by shadow prices), Transmission cost shifts and commodity cost impacts. Power Advisory was also asked to analyze the potential impacts on long term network investment requirements. (**Ex. H1/T3/S1**)

101. The key elements of Power Advisory's analysis are the following:

- The methodology used to determine cost responsibility must reflect the particular circumstances of the network. Although AMPCO asserts that HON's Transmission is largely determined by system peaks that occur during relatively few months HON's Transmission system does not peak at the same time in every area and regional peaks may be very different than system peaks. An increasingly important driver of Transmission investment in Ontario is the need to connect new renewables. These resources tend not to experience their maximum output at the time of peak demands so the Transmission network must be planned accordingly. Thus, Transmission investment is not largely determined by system peaks;

- The Transmission network was built to serve Transmission peak demands throughout the year and in each local region and therefore the High 5 proposal is inconsistent with the cost causality principle where costs are assigned to customers and rate classes in accordance with their contribution to the costs that have been incurred;

- The key elements of AMPCO's benefit analysis are the estimation of shadow prices and the elasticity of demand by industry segment, however the AMPCO analysis is subject to considerable uncertainty;

- Power Advisory's estimates of the net commodity cost reductions area significantly smaller than AMPCO's;

- The cost shifts resulting from the change in methodology are an order of magnitude greater than cost shifts from load shifting and are much larger than the estimated commodity cost savings that would accrue to all customers leaving those that do not shift and reduce their network determinants worse off after the application of the High 5 proposal;

- The Transmission cost shift resulting from the combination of both load shifts and a change in methodology results in $28.5 million more costs being borne by LDC customers and direct connect Transmission customers seeing a reduction in their allocated costs of $20.7 million;

- Power Advisory's estimates of potential commodity savings range from $2.4 million to $.9 million;

- LDC customers that have a lower load factor relative to other LDCs will bear the greatest burden and therefore LDCs with large percentages of heating and cooling will bear the largest burden;

- On balance the High 5 methodology is likely to have a net benefit only to the directly connected Transmission customers and the power station customers. (**Ex. H1/T3/S1/Attachment 1/p. vii**)

102. HON has not taken a position on the merits of the AMPCO approach in this proceeding, but has identified some concerns around implementation. HON is of the view that, if the Board sees merit in the methodology implementation should be deferred until January 1, 2012 for the following reasons:

- It would be appropriate to have a complete year in which the Transmission customers understood the consequences of changing the Network pricing methodology so they have the opportunity to modify their behaviour with full knowledge of the consequences of not doing so;

- The High 5 methodology is based on consumption in the prior year. The 2010 data would not be available in time to determine the 2011 Network payments;

- The IESO has expressed concern about implementation issues that may require further input from the Board or additional stakeholder consultation;
- Time may be required to update the Uniform Transmission Rate Schedules;
- Other transmitters in Ontario will need to assess the impact of the new methodology;
- HON will need to develop new settlement processes with the IESO.

103. HON also identified the issue that adopting the High 5 proposal would result in unequal treatment between large users directly connected to the Transmission system and those that are connected to a Distribution system. (**Ex. H1/T3/S1/p. 6**)

AMPCO

104. AMPCO is essentially proposing a Network charge determinant methodology that has been before the Board in HON's two previous rate cases. AMPCO presented its own evidence and evidence prepared by Dr. Sen of the University of Waterloo.

105. Dr. Sen's evidence set out a methodology for estimating how industrial customers respond to changes in price. He has concluded that industrial customers will reduce demand during peak periods in response to higher prices and that industrial customers will consume more in off-peak periods in respond to higher peak prices. He also concluded that industrial demand response during peak periods cause peak prices to be lower for all customers.

106. Overall it is AMPCO's view that the it proposal would induce demand during peak periods, lower commodity costs overall, reduce global adjustment amounts, lower system losses, and overall electricity costs. (**Ex. M1, p. 14**)

107. AMPCO is claiming that the resulting cost shift among HON's customers would be modest ($.9 million) relative to potential commodity cost savings for all customers ($11.3 million).

SUBMISSIONS

108. In HON's 2007-2008 Transmission rate proceeding the Board made it clear that parties that advocating a changes in how customers pay for Transmission service "need to submit a strong case for change, with detailed evidence and analyses showing why the status quo has undesirable effects and is inappropriate." (***Decision with Reasons*, EB-2006-0501, p. 98**) The proposal before the Board is the same proposal that was considered by the Board in that proceeding. The question for the Board in this case is whether AMPCO has submitted a strong case for change. The Council submits that, although the evidence in this proceeding was more comprehensive than that before the Board in previous proceedings, AMPCO has not made a convincing argument as to why its High 5 proposal would be, on balance, better for Ontario electricity consumers than the status quo.

109. HON, in it 2007-2008 Transmission rates proceeding, and its 2009-2010 proceeding opposed the adoption of the High 5 method for determining charge determinants. In the 2009-2010 proceeding HON expressed concern about the magnitude of the rate impacts and AMPCO's estimate of cost shifting. (***Decision with Reasons* EB-2008-0272, p. 68**) HON, in that proceeding, also expressed a number of concerns with Dr. Sen's analysis. Although HON has not taken an explicit position in this proceeding regarding the merits of the approach and the costs and benefits proposed by AMPCO HON has, as noted above expressed some concerns about implementation and the timing of that implementation should the Board accept that the proposal was reasonable.

110. The Council submits that the Board should give careful consideration to the analysis provided by Power Advisory. The report provided by Power Advisory was provided to HON after an open RFP process. In effect, Power Advisory has no vested interest in the outcome of the Board's Decision on this issue. Power Advisory's overall conclusion is that the proposal is only likely to benefit directly connected Transmission customers.

111. The Council submits that, if there was clear evidence that, on balance, moving to the High 5 methodology would provide a net benefit to all Ontario electricity consumers, it would be appropriate to make the change. The proposal would result in a significant cost shift from large industrial customers directly connected to the Transmission system to those

customers, including residential customers, embedded in the LDCs. All of this in the absence of evidence that significant load shifting will occur. This is at a time when bill impacts for all consumers are mounting and will continue to do so in the coming years. The evidence of Power Advisory and HON is that the proposal will not will result in a deferral or elimination of any network Transmission investments. (**Tr., Vol. 8, p. 128**) Transmission investment in Ontario is now largely driven by the increased level of renewables coming on stream. The potential for commodity cost decreases are small. In addition, many large customers would get a benefit without making any change to the way in which they consume electricity.

112. The proposal is being advanced at the same time as a change in the way in which the Global Adjustment Mechanism ("GAM") is allocated. No analysis was provided by AMPCO to show how the peak and off-peak differential would change given the implementation of both methodologies. (**Tr., Vol. 10, p. 56**) Power Advisory is of the view that this GAM reallocation will have a greater effect on consumer behaviour than the shift that would occur as a result of the implementation of the High 5 proposal. (**Tr., Vol. 8, p. 27**)

113. The Board in this proceeding has only two charge determinant proposals before it, the status quo and the High 5 methodology. The Council submits that the reasons for rejecting the proposal in the past remain valid. There is no evidence that moving to the High 5 methodology will bring about all of the benefits claimed by AMPCO and its representatives. Instead it shifts costs on to customers that have no way to avoid Transmission charges and provides a potential windfall to others. The lion's share of Transmission costs are historical fixed costs and there is no valid reason as to why residential consumers should now bear a larger proportion of those costs. AMPCO has not met the test for change set out by the Board in its previous decisions.

114. The Council notes that the Board, on October 27, 2010, announced that it intends to develop a renewed regulatory framework for electricity Distribution and Transmission. If the Board is convinced that the current Transmission charge determinant methodology is no longer appropriate the Council submits that the Board, should, as a part of that review consider alternative approaches. Given its intent to consider a number of issues regarding network

investment a change in how Transmission is priced would be more appropriate to consider in that context.

ISSUE 9 – THE GREEN ENERGY PLAN

9.1

115. HON has asked the Board to approve its GEP. It does so notwithstanding the fact that most of the projects were deferred, at the direction of the Minister.

116. In deciding whether to approve HON's GEP, the Board faces two particular difficulties. They are, first, knowing what the GEP consists of. The second is knowing what component of the GEP is HON's, and what is someone else's.

117. By way of background, the evidence indicates that most of what comprises the GEP, at least as it existed until shortly before the commencement of the oral hearing, consisted of projects that were schedules to the Minister's letter to HON of September 21, 2009. Some of the projects on those schedules had been worked on before, although they had not been identified as part of a GEP. What made all of the projects part of the GEP was their inclusion in the schedules to the Minister's letter.

118. There is no evidence that HON independently assessed whether any of the projects were prudent. They conceded that there had been no cost/benefit analysis of the kind that HON would ordinarily feel compelled to undertake.

119. Work on the projects was then stopped, as a result of a letter dated May 7, 2010, from the Minister of Energy to the CEO of the OPA. In that letter, the Minister requested the OPA to provide an updated Transmission expansion plan, in view of the FIT tariff program, and the deal with the Korean consortium. (**Ex. I/T1/S98**) Hydro One has indicated that it will not do any further work on its GEP until it receives direction from the Minister after the Minister, in turn, receives a requested update from the OPA.

120. Against that background, it is very difficult to know what HON's GEP now consists of. For that reason alone, the Council submits that the Board should not approve the

GEP *per se*, or, indeed, any component of it. Among other considerations, the Board should not consider a plan without knowing how much, if any, of it will actually proceed.

121. As set out in the "Introduction and Overview" portion of this written argument, the Board faces the dilemma of whether to approve any spending for projects which are not directed by HON and for which HON provides no evidence of prudence. As noted in that section, HON candidly acknowledges that the decision whether to proceed with a GEP is based on a direction from the Minister and based on analyses undertaken by the OPA. HON does not itself assess the prudence of the project, or undertake any cost/benefit analysis. Given that, the Council submits that the Board should not approve, with the exceptions noted below, the recovery of any costs related to GEP spending.

122. HON is asking to recover $2 million in development costs, over the test period, recorded in a deferral account. There is no evidence that the money recorded in the deferral account has been prudently spent. HON asks the Board to assume that, because the money has been spent on GEP projects, it should be allowed to recover it. There is no basis for that presumption. In carrying out its obligation under section 78 of the OEB Act, the Board must undertake an independent assessment of the prudence of the spending. It is simply unable to do so with respect to the amounts recorded in the deferral account.

123. HON also forecasts that there will be money spent on further development work, the cost of which is to be recorded in deferral account. The existence of the deferral account has been approved. However, the Council submits that HON should be put on notice that the GEP has not been approved, and that any development funds spent pursuant to that plan will not be approved unless HON can provide evidence that the funds were prudently spent.

124. With respect to capital spending, HON proposes to add, to rate base, in 2011 and 2012, approximately $125 million representing the cost of the Leaside and Hearn upgrades. The Council submits that there is no evidence that either of those upgrades should properly be considered part of a GEP. Accordingly, a decision by the Board to approve including the cost of those projects in rate base is not a decision, directly or by necessary implication, to approve all or any part of the GEP. The Council submits that, on a stand-alone basis, the Board should approve those projects as necessary upgrades to the Transmission system for Toronto.

125. HON also seeks approval for two projects, the Northwestern Reinforcement Project and the Algoma to Sudbury Project, notwithstanding that there will be no revenue requirement for those two projects in the test year. Given the uncertainty as to whether those projects will in fact proceed, the Council submits that the Board should not approve them.

ISSUE 9.2 ACCELERATED COST RECOVERY - CWIP IN RATE BASE

126. HON is proposing that its 500kV Bruce to Milton Double Circuit Line Project ("BxM") be subject to accelerated cost recovery. The proposal being advanced by HON is to have 100% of the annual Construction Work In Progress ("CWIP") expenditures for the project be treated as if they were added to rate based until the project is placed into service. The financial carrying costs for annual CWIP expenditures are to be treated for cost recovery purposes as if the project was declared partially in-service annually. Under the proposal depreciation expenses would not be recovered. HON's forecast revenue requirement for 2011 and 2012 has assumed that the BxM project would be treated using this methodology. (**Ex. A/T11/S5/p. 1**) HON intends to apply the same treatment to other Transmission projects that form part of its GEP.

127. The revenue requirement impact of HON's accelerated cost recovery proposal adds $43.6 million to the revenue requirement in 2011 and $26 million to the revenue requirement in 2012. In addition, assuming an in-service date of December 2012 for the BxM project the revenue requirement increases by an additional $62.6 million. (**Ex. A/T11/S5/p. 7**)

128. It is HON's position that the accelerated cost recovery of CWIP will provide risk mitigation in the event of project construction work delays due to factors outside of HON's control including delayed approvals or outages. The other justifications for the proposal put forward by HON include greater up-front regulatory predictability, improved cash flow for HON as well as rate smoothing and rate stability for ratepayers. (**Ex. A/T11/S5/p. 2**)

129. On January 15, 2010, the Board released a report entitled, "Regulatory Treatment of Infrastructure Investment in Connection with Rate-regulated Activities of Distributors and Transmitters in Ontario." In that report the Board indicated its intent to consider more innovative approaches to cost recovery primarily in relation to infrastructure investments relating to the accommodation of renewable generation and smart grid development. One of the

mechanisms set out in the report is the accelerated cost recovery of CWIP. The Board noted that it would consider applications on a case by case basis provided that the investment is undertaken by the utility as part of its rate-regulated activity. The Board further noted that applicants must satisfy the "requisite relationship test." Specifically, applicants must demonstrate the need for the infrastructure investment and demonstrate that a requisite relationship exists between the alternative mechanisms requested and the demonstrable risk and challenges faced by the applicant in relation to the investment being made. (**Report of the Board, pp. ii-iii**) HON's proposal is in response to the Board's Report.

130. Prior to issuing the Report the Board the Board undertook a consultation process. As a part of the process Board Staff released a Discussion Paper on alternative regulatory treatment for infrastructure investment. As noted in the Report the analysis relied heavily on U.S. experience and the Federal Energy Regulatory Commission's July 20, Final Rule, "Promoting Transmission Investment Through Pricing Reform". In the Discussion Paper Board Staff made the following observation:

> Including CWIP in rate base is a regulatory treatment that can phase in the cost of large, multi-year projects, and mitigate the potential for a decline in company credit quality during a major construction program. In the US, some utilities have expressed the concern that, without the inclusion of CWIP in rate base, the funding needed for a major construction program can lead to a decline in credit quality and a corresponding increase in borrowing costs and ultimately in rates. Delaying rate recovery for new regulated assets until they are placed in service may, in the case of large, capital-intensive assets have rate implications that may need to be mitigated. In response to these concerns and the need for significant investment in base load capacity, particularly nuclear power many US states have passed legislation and/or put in place regulations to allow for full or partial CWIP to be placed in rate base during the construction of these facilities." (**Staff Discussion Paper, p. 23**)

131. The genesis of the recommendations set out in the Board's Report was the US experience which the Council submits is not analogous to the situation now before the Board with the BxM project. FERC and other regulators pointed to a need to "incent investment" and to address a decline in credit quality and a corresponding increase in borrowing costs.

132. In this case there is no need to "incent" HON to build the BxM line. The project has been mandated by the Government, approved by the Board and is well on its way to completion. In addition, HON has not presented any evidence that if the CWIP approach is not approved it will face a decline in credit quality or an increase in its borrowing costs. In fact it is HON's position that in the absence of Board approval to include CWIP in rate base the project will still proceed. (**Tr., Vol. 3, pp. 39-40**)

133. In the Board Report there is a discussion of qualifying investments. Specifically, the Board has stated:

> The Board recognizes that the Green Energy Act will increase the need for capital investment by distributors and transmitters. That investment is incremental to the more routine or traditional investments aimed at maintaining adequate levels of service and reliability, deploying smart meters and accommodating load growth. The Board also acknowledges that the Green Energy Act-related investments may increase the risks that rate-regulated entities encounter. These risks, noted by stakeholders include those related to project delays, landowner issues, public controversy, siting uncertainties, the recovery of costs and the cancellation of renewable generation projects that were to be served by the new investment." (**Report of the Board, p. 12**)

134. Again, the Council submits that these are not risks faced by HON. In particular, it would be difficult to see how HON would be at risk for the recovery of costs for a project approved by the Government and the Board in through the Section 92 proceeding.

135. Although the accelerated cost recovery approach is largely a debate about the extent to which ratepayers "pay now or pay later" HON is advocating the approach for a number of reasons. HON is of the view that the accelerated cost recovery mechanism will help mitigate the risks surrounding the project. HON cites the primary risk is further delays. (**Ex. A, T11/S5/p. 5**) In addition, HON advocates the approach as one that will provide a smoothing, or phased-in effect on rates, and mitigate the impact that would otherwise take place when the facility comes into service. From HON's perspective the approach will reduce borrowing costs to the benefit of the ratepayers due to improved cash flow. Finally, HON has submitted analysis that over time , under this approach the overall cost to ratepayers goes from $753 million to $695 million. (**Ex. A/T11/S5/p. 6, Ex. I/T1/S122**)

136. The Council submits that HON has failed to demonstrate that the CWIP in rate base approach allows HON to mitigate its own risk. The risk of cost overruns and delays are ultimately borne by the ratepayer, as this project has been approved by the Board and endorsed by the Government. The risks referred to in the US context simply do not apply to HON and the BxM line.

137. As for HON's analysis that ultimately the CWIP approach would be better for ratepayers the Council disagrees. BOMA & LPMA and the School Energy Coalition have provided detailed analyses that demonstrate the CWIP approach in fact increases the costs to ratepayers over time. Their analyses rely on discount rates that differ from the rate assumed by HON. The Council encourages the Board to accept those analyses.

138. Whether the Board determines that the CWIP proposal is more or less costly to ratepayers than the traditional method, the Council urges the Board to consider how smoothing the rate impact of the BxM project would be assist it in addressing the issue of rising electricity bills. Adopting the traditional approach would in the short term reduce the 2011 and 2012 revenue requirements. The Council submits that this should also be an important consideration for the Board in determining the outcome of this issue. It is, in other words, directly relevant to the issue of TBI and to the Board's obligation to protect the interests of consumers with respect to prices.

139. The Council notes that in its Report, the Board asserted that, "Conventional mechanisms continue to be appropriate and should therefore remain the core component of the Board's regulatory treatment of infrastructure investment. Utilities are encouraged to use these conventional mechanisms where appropriate." The Board added that in most instances conventional mechanisms will likely be sufficient to address investment risk. (**Report of the Board p. 10**) The Council submits that the traditional rate recovery mechanism remains appropriate.

140. Should the Board allow HON to include CWIP in rate base, it will set a precedent that LDCs will inevitably, and quickly, follow. For that reasons alone, the Board should allow the inclusion of CWIP only in the clearest, and most compelling, of cases. The Council submits that HON's application is not such as case.

141. The Council also notes that the Board's Report contemplated alternative cost recovery mechanisms to support green energy initiatives. Given the government's recent direction, to the OPA, to review demand and supply, and the concomitant delay in green energy activities, the Council submits that the Board should be very reluctant to use any alternative cost recovery mechanism.

142. In HON's 2007-2008 Transmission rate proceeding HON requested similar treatment for a number of projects including the BxM line. Intervenors made the same arguments in that case that they are making in this context. Among the reasons cited for rejecting the approach in that case were that HON had not established that it was subject to an increased risk with respect to recovery of the cost of those projects and that it had not established the need for "incentives". The Board also agreed that the FERC precedents were not applicable to Ontario context. The Board agreed with the arguments advanced by the intervenors. (**Decision with Reasons, EB-2006-0501**)

143. The Council submits that with respect to the BxM project the Board should rely on traditional rate-making principles and reject HON's request for accelerated cost recovery through the inclusion of CWIP in rate base. The impact on the 2011 revenue requirement of allowing HON to include CWIP in rate base is $43.6 million. In 2012 the impact on the revenue requirement is $26 million.

144. HON has cited potential project delays for the BxM project because of some approvals yet to be granted. HON is waiting for a permit from the Niagara Escarpment Commission and OEB Expropriation approval. Given the fact that the current in-service date is December 31, 2010, if there is any delay ratepayers will pay an additional $62.6 million in 2012, although the line will not be in service, which would be inappropriate. The Council urges the Board to consider the reasonableness of the in-service date and the extent to which the project should be excluded from the 2012 revenue requirement.

III Costs

145. The Council asks that it be awarded 100% of its reasonably-incurred costs for its participation in this proceeding.

All of which is respectfully submitted.

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