EB-2010-0002

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch.B, as amended;

AND IN THE MATTER OF an Application by Hydro One Networks Inc. pursuant to the *Ontario Energy Board Act* for an Order or Orders approving just and reasonable transmission rates for the years 2011 and 2012

FINAL ARGUMENT
ON BEHALF OF THE
SCHOOL ENERGY COALITION

November 2 , 2010

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0 GENERAL COMMENTS

0.1 *Introduction*

0.1.1 On May 19, 2010 Hydro One Networks Inc. filed a two-year cost of service Application for a new revenue requirement and new uniform transmission rates, effective January 1, 2011 and January 1, 2012. The process included extensive interrogatories, a technical conference, an unsuccessful ADR, and a lengthy oral hearing.

0.1.2 This is the Final Argument of the School Energy Coalition.

0.1.3 The ratepayer groups who intervened in this proceeding have worked together throughout the hearing to avoid duplication, including exchanging drafts or partial drafts of their final arguments. We have been assisted in preparing this Final Argument by that co-operation amongst parties. Where we are in agreement with the submissions of other parties, we have not repeated their arguments here, but have adopted their reasoning where applicable.

0.1.4 Except for this first Section, and Section 10, the numbering of Sections and Subsections in this Final Argument is consistent with the numbering in the Board-approved Issues List.

0.2 *Summary of Submissions*

0.2.1 This Final Argument contains a detailed analysis of many of the issues arising in this proceeding. The following are the main recommendations resulting from that analysis.

0.2.2 ***Nature of the Inquiry.*** It is clear from the evidence in this proceeding that this Application is part of a broader plan by Hydro One Networks, on both the transmission and distribution sides, that includes what can only be described as a breathtaking expansion of their business and assets over the next decade. What follows from that is equally shocking rate increases that will test the ability of many Ontario ratepayers to pay their electricity bills.

0.2.3 There is little doubt that significant investments in our electricity transmission and distribution infrastructure are required in the next decade, not only to sustain and renew the existing system, but also to evolve that system into one that reflects the reality of greater distributed generation, largely renewables. We are undergoing a change in Ontario, one that is needed and will have long term benefits. But, it is not free.

0.2.4 Balanced against the need to reinvest in our infrastructure is the need to maintain control over spending, and to do what is needed, not everything that sounds good. This is a normal balancing act that this Board faces in any rate case, but it is a more acute and challenging issue in this case, due both to the magnitude of the dollars involved, and the nature of the changes in the generation and load that will happen over the next decade.

0.2.5 In our submission, the inquiry this Board has been engaged in has at its root three key questions:

- ***(a)*** Which of the many spending plans proposed by the Applicant are justified based on
  - ***(i)*** the long term benefits they will deliver; and
  - ***(ii)*** consistency with the overall infrastructure renewal program?
- ***(b)*** How can the Applicant, with the Board's oversight, contain other spending to minimize the rate impact of the additional spending proposed?
- ***(c)*** Does the resulting balance between spending and cost containment result in rates that are within the reasonable ability to pay of the ratepayers?

0.2.6 Our submissions in this Final Argument seek to focus on those three questions.

0.2.7 ***Key Recommendations.*** In answering those three questions, SEC recommends that the Board take the following main steps in response to the Application:

- ***(a)*** ***Export Revenues.*** Increase the export tariff to $5/MWh effective immediately, increase the revenue offset accordingly, and continue the variance account for this item. In the alternative, increase the export tariff to $3/MWh on January 1, 2011, and to $5/MWh on January 1, 2013 (unless an intervening rate application with compelling evidence demonstrates to the Board that the latter rate is not appropriate).
- ***(b)*** ***External Revenues.*** Increase the revenue offsets for services provided to others and secondary land use, and continue the variance accounts for those two items.
- ***(c)*** ***OM&A.*** Reduce the allowed OM&A by $20.0 million in 2011 and $32.8 million in 2012.
- ***(d)*** ***Capital Expenditures and Rate Base***. Reduce the allowed capital expenditures by 10% in each of the two years of the test period, and reduce the

rate base and revenue requirement accordingly. We also support the submissions of others on working capital and other rate base components.

(e) ***Human Resources Costs***. Send a clear message to Hydro One that the massive expansion of its workforce has to slow down substantially, by approving a budget that includes much lower headcount. Disallow a portion of the amount by which the Applicant's wage levels exceed industry benchmarks. These disallowances are included in the reductions proposed in (c) and (d) above.

(f) ***Capitalization Exemption***. Allow the Applicant's request for an exemption from the IFRS rule that prohibits capitalization of indirect overheads.

(g) ***Cost of Long Term Debt.*** Reduce the cost of long term debt through using the updated information in the evidentiary record.

(h) ***New Deferral and Variance Accounts.*** Deny approval to establish three new deferral and variance accounts.

(i) ***Charge Determinants***. Deny the AMPCO High 5 proposal.

(j) ***Green Energy Plan.*** Deny "conceptual" approval of the Green Energy Plan as being premature. Approve the three Short Circuit Upgrade projects separately from the Green Energy Plan.

(k) ***CWIP in Rate Base.*** Deny approval of accelerated cost recovery for Bruce to Milton on the basis that it does not meet the requirements of the Board's policy in EB-2009-0152, and it is demonstrably not "better for the ratepayers".

1 GENERAL

1.1 ***Board Directions***

No submissions.

1.2 ***Economic and Business Planning Assumptions***

1.2.1 It appears clear that the Application is based on assumptions with respect to the economy and business conditions that are no longer current. This impacts three key areas: the load forecast, the cost escalators, and the cost of capital.

1.2.2 It is not unusual for assumptions to be somewhat out of date. The regulatory process takes a certain amount of time, and a well-prepared application takes some time before that. It is thus not unusual to find that the assumptions come from data that is 12-18 months before the test period. The Board is, in fact, experienced at dealing with this disjunct, and so in the normal case it does not require any specific comment.

1.2.3 We have a more unusual situation here, because 2008 and part of 2009 exhibited a sharp and severe economic downtown, in which the capital markets were significantly askew, and the business climate was disrupted. Economic assumptions based on data from that time are, not surprisingly, inconsistent with both the long term reality, and more current forecasts.

1.2.4 Although we would not normally expect a utility to update their economic and business planning assumptions right up to the time of their hearing, in this case that was probably necessary. However, generally we have concluded that, with the exception of the cost of long term debt, which is discussed later in these submissions, there is insufficient information in the record to identify and quantify all of the impacts of these outdated assumptions.

1.3 ***Overall Increase in 2011 and 2012 Revenue Requirement***

1.3.1 The Applicant is seeking a substantial increase in its revenue requirement at a time when there are many factors increasing the electricity bills of consumers.

1.3.2 It is not, in our view, enough for the Applicant to say that its own costs are reasonable, and therefore they have some sort of “right” to recover those costs. This is not a one-sided process. There are two primary factors. On the one side, there is a menu of possible spending by the utility, with varying levels of urgency and/or priority. On the other side, there is the ability of the customers to pay. Reasonableness is not a test of only the cost side. Reasonableness is also a test of the ability to pay side.

1.3.3 Schools are specifically aware of this tension between perceived "needs" and ability to pay. Like the Applicant, schools have many spending needs that have high urgency and long term benefits. School buildings have roofs that need to be replaced, new schools have to be built, personnel seek pay increases, the cost of supplies increases, etc. Like the Applicant, they are dependent on a decision-maker (in this case, the Ministry of Education) to approve spending plans. Schools understand the position of the Applicant.

1.3.4 And schools understand that, while they may make a great case for funding needs, in fact there is "only so much money available". They must make hard decisions about what roofs they replace, and what supplies they purchase, based on the reasonable size of the funding envelope. They must, in effect, "tighten their belts".

1.3.5 In our submission, like schools the Applicant must accept that all of its priorities cannot be funded, however compelling they may appear. In maintaining the balance between needs and ability to pay, the Board in our view should be cognizant of the many pressures on the electricity bills of all consumers at this time.

1.3.6 To protect the ratepayers, the Board should approve for the Applicant a revenue requirement that challenges the utility management to contain costs, increase productivity, and achieve as many of their spending priorities as possible, within a reasonable but tight budget envelope.

1.3.7 All ratepayers, not just schools, will have to "tighten their belts" to respond to increasing pressures on energy costs at this time. This is a given. What should also be true, and in our submission is the Board's responsibility, is that the Applicant should also be required to "tighten their belt". The current combination of needs and cost pressures will create financial stress on all parties, and that stress, including the responsibility to respond to those pressures, should be shared by all involved, ratepayers and utility alike.

2 LOAD AND REVENUE FORECASTS

2.1 *Load Forecast*

No additional submissions.

2.2 *Other Revenues*

2.2.1 ***General.*** SEC believes that the amount of revenues available to offset the revenue requirement to be collected from ratepayers is too low in three areas: the Export Charge, services provided to third parties, and secondary use of the Applicant's land.

2.2.2 ***Export Revenues.*** In SEC's submission, it is time to start fixing the export tariff. Everyone knows and admits that the current tariff has no empirical foundation. It is long past the point in time when this unfair rate should be allowed to continue to the detriment of the Ontario ratepayers.

2.2.3 The history is now well-known to the Board. This problem was considered in EB-2006-0501, and it was agreed that a study would be performed. It came back before the Board in EB-2008-0272, at which point the study had not been done, and the Board determined that it was time to get the study completed. The Board in fact ordered the Applicant to file an application for a new export tariff within 60 days of the date of that study. The study was completed July 30, 2009, but the Applicant did not file an application to change the export tariff.

2.2.4 In addition to the July 2009 study, by Charles River Associates (the "CRA Study"), there was a further analysis done by IESO in August 2009 (the "IESO Analysis").

2.2.5 The CRA Study is clear, based on empirical data and proper analysis, that an export charge of $5/MWh is the optimal result. With no evidence other than that, it is submitted that the Board must conclude that $5/MWh is the rate that is fair, and maximizes the overall Ontario benefit in the public interest.

2.2.6 The IESO Analysis does not really challenge the conclusion in the CRA Study. Indeed, it appears to confirm that CRA was correct. However, despite that conclusion the IESO Analysis goes on to conclude that, since the dynamics of the demand/supply balance in Ontario is changing due to the Green Energy Act and other factors, and in particular surplus baseload generation, the Board should delay making any changes to the export tariff for another two to four years. This would allow IESO the opportunity to get more experience with the new system dynamics, and would inform the setting of the export tariff. In the meantime, in IESO's view the lower export tariff has operational benefits.

2.2.7 In short, IESO proposes more study before fixing the problem.

2.2.8 Using IESO's approach, the erroneous export charge, which was first implemented in 2000, will have been in place more than 12 years before it is fixed, and at least eight years after the problem was first brought before this Board. Each year that it remains at the incorrect amount, it costs Ontario ratepayers something in the order of $40 to $50 million in excess transmission rates. An additional two to four years of study sends the Ontario ratepayers a bill for another $100 to $200 million to subsidize exports to other jurisdictions.

2.2.9 In our submission, this is not acceptable, and is not an appropriate result for the Board to reach.

2.2.10 Based on the evidence before it, it is submitted that the Board has evidence supporting only one just and reasonable rate, and that is $5/MWh. No other export tariff has any evidentiary foundation, and therefore by definition no other rate can be found to be just and reasonable, including the present rate.

2.2.11 In this regard, we recognize that the evidentiary foundation is not primarily based on a cost causality analysis. This is because there is no effective difference between the costs caused by the export of electricity, and the costs caused by transmitting it from generation source to load delivery point within the province. Unless one seeks to analyze this on the basis of marginal costing (which the Board has consistently rejected as a cost allocation methodology), the costs that should be borne by anyone using the transmission system should have a similar basis, no matter where the electricity is destined to be used. For this reason, both the CRA Study and the IESO Analysis accept that the best analysis is an overall benefits analysis, rather than a cost allocation.

2.2.12 We note Board Staff's submission [pp. 29-32 of their Final Argument] that they cannot recommend any change to the export tariff. With respect, that conclusion flows from faulty logic.

2.2.13 The Board Staff submission starts from the premise that the Board's decision is whether to <u>change</u> an existing rate. SEC submits this is incorrect. The Board's statutory authority whenever it has an application before it is to set just and reasonable rates. The statute never refers to any decision to change a rate. Rates are set, period.

2.2.14 The Board Staff argument might have more force if the $1/MWh rate had an empirical basis of its own. It does not. It appears to be common ground that this rate was an interim compromise, and has never had any empirical or evidentiary basis. It is just a number.

2.2.15 Therefore, for the Board Staff position, or that of IESO or any other party, to be correct, the Board would have to conclude that the $1/MWh is just and reasonable simply because it was approved at some point in the past. Therefore, as between a rate that has been found to be just and reasonable, and any other rate, the existing rate would prevail unless displaced.

2.2.16 That would, of course, be true of most rates, since most rates are established based on evidence that they are just and reasonable. No-one claims that the $1/MWh is based on evidence. Therefore, to accept the Board Staff position the Board would have to ignore the fact that $5/MWh has evidence supporting it, and $1/MWh does not. This is not, in our submission, consistent with the Board's approach to establishing rates.

2.2.17 It is therefore submitted that the Board should require the export tariff to be changed to $5/MWh effective January 1, 2011, and adjust the revenue requirement to be collected in the uniform transmission rates accordingly.

2.2.18 We also note that, if the Board accepts this recommendation, the information the IESO needs to assess how a higher export tariff will play out in the market with the new system dynamics will immediately be available. The next time the Applicant comes in for rates, there will be data that shows, in the new environment, what happens when a reasonable transmission rate is applied to exports. We will not be faced with a further "study the problem" request, by IESO or anyone else, for example to try out small changes to the rate at that time.

2.2.19 In the alternative, it is submitted that if the jump from $1/MWh to $5/MWh is too high for the Board to impose all at once, the appropriate response is to set the changes in place to move to the rate that the evidence supports, but step by step.

2.2.20 In this regard, we have reviewed the submissions of BOMA/LPMA on this point [pp. 41-46 of their Final Argument], and respectfully disagree with their recommendation. In our view, the small steps they have proposed are insufficient.

2.2.21 Instead, it is proposed that, if the Board is not prepared to move to $5/MWh immediately, the Board should move to $3/MWh as of January 1, 2011, and further order that the rate should increase to $5/MWh as of January 1, 2013.

2.2.22 This alternative recommendation does three things.

2.2.23 First, it moderates the impact of the change on the market.

2.2.24 Second, it provides immediate information for IESO to study the impacts of the somewhat higher rate on the changing system and market dynamics.

2.2.25 Third, it establishes a timeline in which the Board is no longer willing to wait for the various players to finish "studying" the problem. If there is really a concern about the $5/MWh rate, then IESO can get on with studying the market impacts. The results of their improved analysis can be provided to the Board in Hydro One's next transmission rate case, in time for the January 1, 2013 date. On the other hand, if IESO does not see this as urgent enough to complete the analysis in time, or if Hydro One elects to retain 2012 rates in 2013, then the Ontario ratepayers are protected by the increase to $5/MWh.

2.2.26 We wish to make two other comments about this issue.

2.2.27 The question has been raised whether a higher export charge would make it more difficult to sell electricity to export markets, and therefore limit the IESO's flexibility in operating the Ontario grid. This is not correct.

2.2.28 The price that concerns export buyers is the total delivered price of the electricity. This includes both the cost of the commodity itself, and the cost to get it to the buyer, i.e. the export charge. If the export charge is increased, then the impact on the buyer will depend on whether the buyer has other options. If they don't, they must pay the higher price for the electricity. If they do, then the Ontario vendor must reduce their commodity cost in order to complete the sale. In general this does not affect whether exports are available to deal with surplus baseload generation. It only affects the price of the commodity portion of the sale. (This market reality is implicit in the conclusions of both the CRA Study and the IESO Analysis.)

2.2.29 The exception to this comes if the buyer can affect the price (so the commodity portion must go down), and the resulting commodity price is too low for the seller. In that case, the seller, unable to supply to the grid, must adopt other options for dealing with their excess supply, including market bidding strategies and shutdown options.

2.2.30 In our submission, where these other options have to be considered, it is because they are more efficient ways to deal with surplus baseload generation. Having the transmission ratepayers subsidize the export option is not the best way to ensure that the most efficient method of dealing with SBG is applied.

2.2.31 The other question that has been raised during the hearing (and in the hallways) is whether the Board should defer to IESO on this decision. With all due respect to IESO, IESO has a clearly defined role, and that role does not include setting just and reasonable rates. That is the Board's responsibility, and in our submission it would be poor regulatory policy, and contrary to law, to adopt the conclusion of IESO because it was their conclusion, rather than based on the evidence before the Board.

2.2.32 We note that if there is really a justification for Ontario ratepayers subsidizing electricity exports, and thus setting transmission rates on a basis that is patently not just and reasonable, IESO is free to go to the government and seek approval for such a subsidy. If they can make their case based on the public interest, they should do so, and the government can make a decision to provide an exception to the just and reasonable rule. IESO has not done so, and in our view it would be unlikely that the government would approve such a subsidy anyway. Nevertheless, in the absence of such a decision, in our submission it is the Board's responsibility to determine just and reasonable rates, and IESO's opinion, while worthy of respect, is not and cannot be determinative.

2.2.33 ***Services to Third Parties.*** It is submitted that the forecast drop in these revenues is unsupported by the evidence. An increase to $15.0 million, and a corresponding increase in the cost to provide these services to $13.0 million, is warranted.

2.2.34 We comment on the continuation of the related variance account under Issue 6.1 below.

2.2.35 ***Secondary Land Use Revenues.*** The forecast of these revenues by the Applicant appears to us to be inconsistent with past history [Ex. E1/1/2, Table 1]. The average of revenue from this source for each of the past three actuals is $17.2 million (with the Bridge Year forecast in doubt at the present time). In our submission, it is appropriate to change the forecast to reflect the most recent three years of actuals, $17.2 million.

2.2.36 We comment on the continuation of the related variance account under Issue 6.1 below.

3 OPERATING COSTS

3.1 *Sustaining, Development, and Operations OM&A*

3.1.1 Other parties will provide detailed submissions on individual components of the OM&A spending proposals of the Applicant. Many of those submissions that we have seen raise credible issues about the appropriateness of parts of the OM&A budget.

3.1.2 SEC is concerned with the overall level of OM&A spending proposed by the Applicant in these categories, and the long term plans to increase the annual costs to be borne by the ratepayers. OM&A in 2008 was $373.8 million. The Applicant is now proposing OM&A of $450.0 million in 2012, which is a 20.3% increase in OM&A over four years.

3.1.3 Further, that is affected by the $13 million drop in Shared Services and Other OM&A, some of which is less controllable than most OM&A Costs, and it is affected by the increase of only 11.4% in Taxes other than Income Tax, which is not a controllable cost. When these are taken out, the main bulk of the Applicant's OM&A – Sustaining, Development, Operations and Customer Care – is proposed to increase from $249.6 million in 2008 to $331.4 million in 2012. This is an $81.8 million increase, i.e. 32.8%, over four years.

3.1.4 In our submission this high increase is not reasonable, and that is particularly true given the heavy emphasis on capital spending in the test period (which tends to shift personnel from OM&A to capital projects).

3.1.5 We are conscious that, of the $81.8 million increase, $49 million has already been approved by the Board in its previous decision, EB-2008-0272, an increase of 19.6%. The question in this proceeding is whether, given the size of the increase already allowed the last time around, it is reasonable to allow a further increase of 13.2% over two years, or $32.8 million. In our submission, that is not reasonable.

3.1.6 SEC believes, consistent with our earlier comments on the context of this proceeding, that, particularly in view of the expanded capital expenditure plan, and the shifting of costs from OM&A to capital, it is appropriate for the Board to approve an OM&A budget for Sustaining, Development, Operations and Customer Care of $298.6 million for each of 2011 and 2012. This would represent a freeze of spending in those categories, which we believe is appropriate, and would reduce the revenue requirement for 2011 by $20.0 million and for 2012 by $32.8 million. It would also still allow an accumulated increase over the four year period of 19.6%, which is ample.

3.1.7 We note that the adjustments we propose above are inclusive of, and not incremental to, the reductions in Human Resources OM&A discussed under Issue 3.3 below.

3.2 *Shared Services OM&A*

3.2.1 See our comments under Issue 3.1 above and Issue 3.3 below.

3.3 *Human Resource Costs and Levels*

3.3.1 ***General.*** The Applicant has had an ongoing problem with its human resource costs, and the Board has, in successive proceedings, been increasingly firm about the need to take steps to deal with those costs. It is therefore somewhat surprising that the witnesses for Hydro One would continue to provide reasons for their failure to bring these costs under control, rather than reports of real success in doing so. The Board has heard the "heavily unionized" argument several times before, and despite that argument has insisted that Hydro One deal with this issue, including disallowing recovery of costs where the compensation levels are too high.

3.3.2 There are a number of elements of human resources costs, but in these submissions SEC will focus on two areas: the rapidly increasing headcount proposed by the Applicant before, during and after the test period, and the levels of compensation per employee relative to benchmark levels.

3.3.3 ***Headcount.*** The increases in staffing levels that the Applicant has already implemented, and is proposing for the test period and subsequently, are shocking, on two counts. First, the absolute numbers show sharp and continuing increases. Second, until cross examination by SEC, the Applicant had before the Board headcount information that was, to their knowledge, incorrect.

3.3.4 On the latter point, we recommend that the Board look at Tr.5:61-73, where the Applicant first disclosed that the numbers of people included in their evidence, and the costs associated with those people, had not been updated when they changed the workplan.

3.3.5 Since SEC sought to cross-examine on the sizeable increases in headcount, SEC ended up being denied that opportunity because the witnesses suggested that the information on which questions were being asked [I-4-35, Attachment 1] was materially incorrect.

3.3.6 We would also ask the Board to consider the update of that information, in Undertaking J5.1. In that, the Applicant reveals that the impact of the workplan changes was only "40 to 50 fewer regular employees". Thus, we could have cross-examined in full on these issues at the time, since the reduction (a 1280 employee one-year increase reduced to 1230 or 1240) was not material.

3.3.7 Of course, preventing proper cross-examination on the growth in the number of employees cuts both ways. While it succeeded in making it difficult for the intervenors, and the Board, to ask meaningful questions about the headcount increases, it also leaves the huge increases in numbers of employees unexplained. The effect is to allow the parties and the Board to draw the obvious inferences from the facts.

3.3.8 That then leads back to the first point. The headcount numbers set out in I-4-35, Attachment 1, show increases in year-end headcount of more than 3,000 from 2007 to 2012, i.e. over 5 years. The 2007 number is 5,893, and the 2012 number is 8,938 [these numbers also appear in K5.1].

3.3.9 Now, the 2012 number is, according to J5.1, high by 40-50. Therefore, the increase is only about 3,000 employees over that five year period, 51%. On average, Hydro One is adding about 600 employees per year. The high year is 2010, with 1230 employees added. 2011 is average, which a 578 employee addition, while 2012 adds only 150.

3.3.10 Now, the Applicant is quick to point out that this combines distribution and transmission employees, and it is not possible to divide them up. They are also quick to point out that they don't keep records of FTEs (or headcount, for that matter) for each of distribution and transmission, so it is impossible to determine how much of the complement is applicable to the current transmission application, and how many people in total are really doing the work.

3.3.11 In our view, this is simply unacceptable. This regulated entity cannot come to this Board, asking for billions of dollars of spending approvals, and say they can't tell you how many people that represents. And, that is particularly true when human resource costs have been a longstanding and important cost issue with the Applicant, and one that they essentially confess they have been unable to address adequately.

3.3.12 It is submitted that the Board should assume that this Applicant, which reports an overall wage cost increase of 68% over five years [I-4-35], largely driven by a massive increase in the work force, is experiencing that compensation cost pressure equally on the transmission and distribution sides of its business. Further, the Board should assume, absent any evidence to the contrary, that the huge hiring bulge is at least as much the result of transmission expansion as distribution expansion.

3.3.13 And, in our submission, the Board should tell this utility that this increase is unacceptable, and they must put a plan in place to get this under control.

3.3.14 There are two key reasons why it is important that the Board act firmly at this time.

3.3.15 First, the headcount increase is the main reason for the increase in costs and rates in the last five years. The average wages per employee increase in that period from $84,083 to $93,153 in that period, a 10.8% increase. While, as we note below, this starts from too high a base, and while this does not include the substantial non-wage component of compensation, the increase is at the high end of the reasonable range.

This is not the bulk of the human resource cost increase. The 68% comes not from increases in wage rates. It comes from the expansion of the workforce.

3.3.16 We therefore ask that the Board cut back on the human resource costs in OM&A and capital, reflecting the fact that unreasonably high increases in headcount are planned and proposed.

3.3.17 Second, this ballooning of the workforce is exacerbating an already difficult problem. The Applicant claims that their main problem with getting human resources under control is that they are unionized. Their solution is to hire thousands of additional unionized employees.

3.3.18 The Applicant argues that the workplan needs the additional resources. We don't believe that is true, but even if it were, hiring 3,000 more full-time employees is not the way to solve that. What that creates, instead, is a highly-paid workforce that, once the current glut of capital projects is complete, will still need work to do. The utility will then be faced with two alternatives. It can try to cut back on its unionized work force, or it can find new projects to keep them busy.

3.3.19 The time to head this problem off is now. The Board has seen the spending plans of this utility out several years, and clearly further headcount increases can be expected before this expansion comes home to roost. Before that happens, it is submitted that this Board should send a clear signal that the evidence in the proceeding does not support such a shocking increase in the number of people working for Hydro One.

3.3.20 We have two other comments about the number of employees.

3.3.21 Much confusion has taken place in this proceeding with regard to the difference between headcount and FTEs, and the Applicant's steadfast refusal to provide FTE information on a time sequence and comparable basis. What we do know [Tr.5:63] is that the headcount numbers are lower than the FTE numbers, generally speaking, because a number of people are laid off late each year. Thus headcount, which is a point in time calculation, usually at December 31st, does not count many people who have worked for much of the year.

3.3.22 Our other comment has to do with the aging workforce argument. We note that the Applicant, like many utilities, has argued that they need to hire new people in order to replace those who are retiring. However, it is submitted that the evidence does not support this proposition. In our submission, the evidence supports the view that replacing retirees is something that happens to any utility, including Hydro One, in the ordinary course of business. Hydro One can cast the "pending retirements" information any way it likes, the fact is that management has been saying internally this was an acute problem for many years, and it never seems to materialize. The levels of hiring that appear to be based on planning for retirements far exceed the actual retirements that are taking place, even on a lagged basis.

3.3.23 ***Compensation Levels.*** The other part of this equation is the levels of compensation at Hydro One. This is a problem not just in terms of the revenue requirement implications for Hydro One, but also the impact on the market for skilled electricity utility employees in Ontario. Overpayment by Hydro One pushes up the amounts that every other utility in Ontario has to pay to recruit or keep good people.

3.3.24 Our comments on compensation levels are in two steps.

3.3.25 The simple part of this analysis is the Mercer study, and the conclusion, set out in the EB-2008-0408 decision, that the revenue requirement would be $13 million lower if Hydro One paid comparable employees on the median rather than substantially in excess of the median benchmark.

3.3.26 In EB-2008-0408 the Board took a first step in trying to correct this reducing the allowed OM&A by $4 million in each of the two test years, so $8 million of the $13 million excess.

3.3.27 On this part of the analysis, we agree with Board Staff [at page 6 of their Final Argument] that it is time to take the next step, and disallow the full $13 million excess.

3.3.28 The second part is more difficult. It turns out that the job categories that are supposed to be comparable in the benchmarking material before this Board have actually been selected by Hydro One, and are not really comparable.

3.3.29 There are several examples of this, but the best is probably the comparison of Hydro One's Powerline Maintainer position to similar positions at other utilities [J4.7]. When questioned about this, the witnesses for the Company admitted that the people at Hydro One who actually maintain their lines are not primarily the Powerline Maintainers, who in 2009 made $35.46 per hour. Rather, Hydro One has a job classification Regional Maintainer – Lines, which is paid at a rate substantially in excess of that. When asked about that, the witness admitted that not only are the "vast majority" of the linepersons at Hydro One in the Regional Maintainer category, but the Applicant even hires apprentices for that position [Tr.5:78-79].

3.3.30 An indication of the extent to which the "real" position is Regional Maintainer – Lines, not Powerline Maintainer, is found at I-7-5 and J5.2, where the six major PWU positions are listed for the purpose of showing hiring and retirements. Powerline Maintainer is not listed. Regional Maintainer – Lines is not only listed, but comprises almost half of the volume of hires and retirements in the table.

3.3.31 It is therefore submitted that the benchmarking comparisons provided in the evidence likely do not tell the full story. From the examples the Board has seen, it is likely that the extent to which Hydro One is above industry benchmarks is more than the studies reveal.

3.3.32 ***Conclusion and Recommendation.*** There are two problems here, and both need to be addressed.

3.3.33 The problem with high average wage levels has been quantified, and is at least $13 million, even before the issue of comparable job categories is factored in, and even if 2008 impacts have not escalated since then.

3.3.34 The problem with the massive increase in headcount is less easy to quantify. As a rough benchmark, we suggest that 500 or more of the 1230 additional employees proposed for 2010 are probably in excess of reasonable needs, especially given the additional net 578 to be added in 2011 and 150 in 2012. At the average wage level of $93,153 cited by Hydro One, and without even including non-wage compensation, this is more than $46 million per year during the test period. If we assume that 50% is applicable to transmission (which may be low) that is a $23 million per year reduction in wage levels.

3.3.35 In our submissions under Issue 3.1 above we have proposed reductions in revenue requirement relating to OM&A totaling $52.8 million over two years. In our submissions under Issue 4.1 below, we have proposed reductions in the capital program of 10% in each of 2011 and 2012.

3.3.36 It is our submission that the human resource cost reductions we are proposing are subsumed within those reductions, making up the bulk of those savings.

3.3.37 Further, it is our submission that, even with these reductions, the human resource costs of Hydro One, and their headcount, are substantially in excess of reasonable amounts. Rather than try to get to a reasonable level immediately, however, we believe that it is more appropriate for the Board to take a firm step in the right direction, with the expectation that future reviews may find additional savings.

3.3.38 We note, in this regard, that the ultimate goal is to encourage a change in corporate culture at Hydro One, whereby this kind of cost management comes from within, rather than being imposed by the Board. In the EB-2010-0008 proceeding, we have heard testimony from the applicant Ontario Power Generation of just such a change. While it is not yet clear whether that change is as thorough and far-reaching as is claimed, it is clear that a change is happening, driven in large part by messages sent by this Board in their previous rate case. We urge this Board panel to send a similar message to Hydro One.

3.4 *IPSP and Other Preliminary Planning Costs*

No additional submissions.

3.5 *Allocation Methodologies and Capitalization Rate*

3.5.1 Hydro One seeks permission to continue to capitalize overheads, as an exception to the incoming IFRS rules, and the Board's report in EB-2008-0408. The impact of ending the capitalization of overheads would be to increase the annual revenue requirement, starting in 2012, by about $200 million.

3.5.2 In our submission, this exception should be allowed, for two reasons.

3.5.3 The first reason is that IFRS is an accounting standard, not a regulatory standard. The purpose of disallowing the capitalization of overheads, in our opinion, is to ensure that the financial statements on which investors rely are more conservative, i.e. that companies seeking investor funds or reporting to the public markets cannot bury spending in capitalized overheads.

3.5.4 However, from a regulatory point of view the Board is not and should not be concerned with erring on the conservative side. The purpose of regulatory accounting is not to ensure that investors get the whole story. It is, instead, to ensure that costs are fairly matched to the benefits received by customers. Rules like "used and useful" are good examples of that principle. While there is a matching principle in financial accounting as well, it is not conceptually the same, because it does not have a fairness element, and it is still tinged with the conservatism principle.

3.5.5 We recognize that the Board, in the EB-2008-0408 Report, was aware of this argument, and nonetheless opted for adopting the IFRS capitalization rule. However, we note two things. The Board was not aware in writing that report of the magnitude of the impacts overhead capitalization could create, e.g. $200 million a year in this case. As well, the Board was clear in that report that actual decision relating to the adoptions of IFRS for individual utilities would be made, not in that policy consultation, but in rate cases like this one. .

3.5.6 The second reason is that the IFRS rules, and the timing of their implementation, are still in a state of extreme flux. It is not at this point clear whether the overhead capitalization rule will be changed effective 2012, 2013, 2011, or some other time, if at all.

3.5.7 It is therefore submitted that the Board's appropriate response is to allow the exemption sought by the Applicant, with the understanding that it will be revisited in the next proceeding, when the Board will have a better picture of what IFRS requires, and when, and what the impacts will be of a change.

3.6 ***Income and Other Taxes***

3.6.1 We have had the opportunity to review the submissions of BOMA/LPMA [pp. 36-41 of their Final Argument] with respect to taxes, and we adopt both the analysis and the conclusions in those submissions.

3.7 ***Depreciation Expense***

3.7.1 Except as may arise as a consequence of our submissions in other parts of this Final Argument, we have no additional submissions under this issue.

4 CAPITAL EXPENDITURES and RATE BASE

4.1 *Overall Amount of Rate Base*

4.1.1 We are very concerned about the Applicant's long term plans for large increases to their rate base. In considering the entire record, including the confidential and non-confidential documents supplied on the record, SEC believes that the Board should consider whether the Applicant's long term plans could significantly affect ratepayers, including potentially making many Ontario businesses uneconomic.

4.1.2 It is, of course, clear that this Board panel does not have jurisdiction to make binding orders with respect to spending in periods beyond December 31, 2012. This is a rate case for 2011 and 2012, and the spending plans beyond that are not part of the Application.

4.1.3 That having been said, the Board cannot completely turn a blind eye to the Applicant's plans beyond the test period, because the Board will in fact be called upon in the future to set just and reasonable rates for that period. To say nothing today, when at least some of the Applicant's long term plans are known, is in our view to abdicate the supervisory role that the Board plays with respect to the utilities it regulates.

4.1.4 In our submission, the Board should make clear to the Applicant in its Decision that, while it is not prejudging spending plans beyond the test period, the Board has significant concerns about the size and speed of the increases the Applicant is planning.

4.1.5 The Applicant, faced with such a non-binding but clear message, would then have two choices. It could adjust its long-term spending plans to accomplish the same overall goals at lower cost to ratepayers, or it could develop a more robust support of the planned spending levels to assuage the Board's concerns when approvals are actually being sought. Although we may prefer one result over the other, either result is beneficial.

4.1.6 Subject to the above, we have no additional submissions on the rate base proposed. However, some of our other submissions in this Final Argument would, if accepted by the Board, affect the rate base to be used in the calculation of the revenue requirement for the test period.

4.2 *Sustaining, Development, and Operations Capital Expenditures*

4.2.1 The Applicant consistently, year after year, spends about 10% less on capital projects than they plan, and in past year 10% less than the Board has approved. Their revenue requirement is established based on what they hope to accomplish, but reality sets in and they are unable, for various reasons (not all of their own making), to complete the spending levels originally planned and approved.

4.2.2 It would appear to us, based on this consistent pattern, that the Applicant's capital planning suffers from a bit of "rose-coloured glasses". In setting their budget, the Applicant apparently fails on a regular basis to take sufficient account of the limitations that will be placed on their projects due to their own finite resources and the actions of third parties (e.g. for approvals and availability of contractors).

4.2.3 The real solution to this is for the Board to encourage Hydro One to take steps to improve their capital planning process, so that the plans can be more reliable. In the meantime, in our submission the Board should step in and reduce the capital budget in light of the past history.

4.2.4 We have had an opportunity to review the analysis of this issue by BOMA/LPMA [at pp. 5-7 of their Final Argument]. While we agree with the analysis, we do not agree with the conclusion. In our view, the pattern is clear, and the revenue requirement should be adjusted to reflect a 10% reduction in capital spending in the test period.

4.2.5 We note that the impact on the Applicant of this adjustment is not as significant as it might initially appear. If it turns out that, in 2011 and 2012, unlike past years, the Applicant is able to complete the spending program included in the budget presented to the Board, the opening rate base in 2013 will be that much higher, and the Applicant will effectively be able to say "I told you so" to all of us. The lost revenue requirement for 2011 and 2012 will not be a significant component of the cost of the $100 million plus of incremental rate base additions in each of the test years. By far the bulk of the cost will still be in rate base, to be recovered from the ratepayers in the normal course if the spending was prudently incurred.

4.2.6 On the other hand, the effect of excluding this 10% from the capital budget for 2011 and 2012 is to provide strong encouragement – at a relatively low cost – for Hydro One to improve its capital planning process for the future. .

4.3 ***Shared Services and Other Capital Expenditures***

4.3.1 Aside from our comments above under Issues 4.1 and 4.2, our only comment with respect to this category of capital spending relates to major IT capital projects.

4.3.2 In general, SEC strongly supports initiatives by regulated utilities to improve the quality and extent of their IT infrastructure. Done correctly, increased "automation" of the utility's business and decision-making activities will often result in long term cost savings, while maintaining or improving reliability, safety, and customer service.

4.3.3 This is, of course, true of most large companies, but there is a countervailing concern.

Large companies have to guard against the tendency to continually buy the next great technology, without being rigorous about whether the incremental value of that technology is worth the incremental cost. Utilities sometimes do not ask the question "Is this so much better than what we have that we should spend $X to get it?" Instead, they can sometimes react to the availability of new technology with "That would really make our lives a whole lot easier."

4.3.4 What concerns us is that management of utilities, who regularly make tough judgment calls about whether operating assets like transformers and circuit-breakers that are old but serviceable need to be replaced, may not be equally hard-nosed when making similar decisions about technology. While it is clear that information technology is changing at a more rapid rate than electrical infrastructure gear, it is sometimes striking how much more up-to-date utilities will keep their IT infrastructure relative to their physical plant.

4.3.5 That having been said, the Board will be aware that SEC engaged in a thorough cross-examination of the Applicant's witnesses on the subject of IT infrastructure, and in particular the Cornerstone Project. In doing so, we were exploring whether Hydro One was being sufficiently hard-nosed in its decisions on upgrading its IT infrastructure. While our sense after that cross-examination was that they might be spending more on this upgrading process than was necessary, we could not conclude, reviewing that evidence, that any specific spending should be challenged.

4.3.6 On the other hand, the IT renewal plan reaches into the future as well, and the future steps do appear to have some plans that look to us more like "wish list" than needs.

4.3.7 SEC therefore does not oppose the capital budget, but does want to sound a warning that Hydro One's IT infrastructure spending may be reaching the point where it is time to slow down (in the sense of "taking a breather") in this area.

4.4 *Allocation Methodologies*

4.4.1 See our submissions under Issue 3.5 above. With that exception, we have no additional submissions on this issue.

4.5 *Working Capital*

4.5.1 We have reviewed the submissions of BOMA/LPMA with respect to the calculation of working capital [pp. 13-15 of their Final Argument], and adopt both their analysis and their conclusions.

4.6 *Asset Condition Assessment*

No additional submissions.

5 CAPITAL STRUCTURE AND COST OF CAPITAL

5.1 *Capital Structure*

No additional submissions.

5.2 *Return on Equity and Short Term Debt*

No additional submissions.

5.3 *Long Term Debt*

5.3.1 We have reviewed the submissions of BOMA/LPMA [pp. 52-56 of their Final Argument], and the submissions of Board Staff [pp. 20-21 of their Final Argument] on this issue. We agree that the cost of long term debt in the Application is likely overstated, and we adopt the solution proposed by BOMA/LPMA as the appropriate response by the Board.

6 DEFERRAL AND VARIANCE ACCOUNTS

6.1 *Amounts, Disposition and Continuation of Existing Deferral and Variance Accounts*

6.1.1 ***External Station Maintenance and EC&S Revenue Account.*** Consistent with our submission under Issue 2.2 that the forecast of this revenue be increased, it is submitted that the variance account for this purpose should be continued so that any excess will be paid to the ratepayers, and the Applicant will be protected if there is a shortfall.

6.1.2 ***External Secondary Land Use Variance Account.*** Consistent with our submission under Issue 2.2 that the forecast of this revenue be increased, it is submitted that the variance account for this purpose should be continued so that any excess will be paid to the ratepayers, and the Applicant will be protected if there is a shortfall.

6.1.3 ***Export Revenues Variance Account.*** Consistent with our submission under Issue 2.2 that the forecast of this revenue be increased and the rate at which the export tariff is charged be adjusted, it is submitted that the variance account for this purpose should be continued so that any excess will be paid to the ratepayers, and the Applicant will be protected if there is a shortfall.

6.1.4 Subject to the above, we have no additional submissions on this issue.

6.2 *Disposition of IPSP and Other Preliminary Planning Costs Account*

No additional submissions.

6.3 *New Accounts*

6.3.1 ***OEB Costs Differential Account.*** We support the submission of Board Staff that this account is unnecessary.

6.3.2 ***Two IFRS Accounts.*** It appears to SEC that these two accounts are not required and not appropriate.

6.3.3 The account to record gains and losses on the disposition of assets is useful only if the Applicant has material gains and losses, and elects to change to comply with IFRS in 2012 rather than continue with the current regulatory accounting treatment. The fact that the Board has no information on the potential impact of this account is a significant concern.

6.3.4 The account to record changes in revenue requirement due to IFRS impacts in 2012 is entirely inappropriate. In our submission, this amounts to an unacceptable exception to the forward test year concept for 2012. It is Hydro One that has elected to seek a two year cost of service for transmission. The imposition of IFRS changes in the middle is a direct result of that decision. Although the IFRS effective date has recently changed from 2013 to 2012, prior to that it changed from 2011 to 2013, and more changes are possible.

6.3.5 A two year forward test period will always have more forecast uncertainty than a one year period. When a utility elects a two year test period, they must be taken to have accepted that additional forecast uncertainty. It is not appropriate, in our submission, for a utility to seek the benefits of a two year period, but ask to be protected from the additional forecast uncertainty that they have already chosen to accept by their proposed ratemaking method.

6.3.6 In our view, if the introduction of IFRS ends up having additional, significant changes to Hydro One's 2012 revenue requirement, then the appropriate solution is to file revised material on a cost of service basis for that year, when the changes are known or reasonably foreseeable. At that point, the Board can assess how best to deal with the impacts of IFRS in the appropriate context.

6.3.7 We note that variance accounts similar to this were proposed by many parties, including Hydro One, during the EB-2008-0408 proceeding, and were rejected by the Board for the very reason we are raising here, i.e. that IFRS changes are best dealt with when the impact is known, and in the context of a rate application that shows the other impacts on rates that are expected.

6.3.8 For these reasons, we believe the second IFRS account should be rejected by this Board.

7 COST ALLOCATION

7.1 *General*

No additional submissions.

8 CHARGE DETERMINANTS

8.1 *High 5 Proposal*

8.1.1 SEC is opposed to the AMPCO High 5 proposal in its current form. In our submission, while there are many reasons to reconsider the charge determinants for transmission, the case has not been made that the High 5 proposal would be an improvement over the current structure.

8.1.2 It would appear to us that there are really only two possible reasons why the High 5 proposal would be selected over the current structure, or any other alternative:

(a) It can be shown that it is based on a fairer or more rigorous allocation of costs between ratepayers; or

(b) The new charge determinants will incent customer behaviour that creates a greater net benefit to the system as a whole, and therefore to all customers.

8.1.3 ***Cost Allocation.*** With respect to the first point, the evidence shows [I-2-36a] that implementation of the High 5 proposal would result in a shift of about $21.4 million of cost responsibility from the direct and power producer customers to the customers of the LDCs. We have not seen any compelling evidence that, on the basis of cost causality, the directs and power producers are currently subsidizing the customers of the LDCs in this amount, or any other amount.

8.1.4 Therefore, in our submission the High 5 proposal is not supported on the basis of "correcting" the cost allocation.

8.1.5 ***Customer Behaviour***. AMPCO led evidence that the High 5 proposal could result in changes to customer behaviour that reduce overall costs on the system and therefore benefit all customers. There are two reasons, we believe, why this evidence is not persuasive.

8.1.6 First, it is not obvious that the load shifting that is possible under the High 5 proposal, 430 MW by the directs [as concluded in the Power Advisory Report], will produce material changes in transmission spending (or generation spending, for that matter). It does appear clear that distribution spending will not be affected.

8.1.7 Second, the evidence shows that peak load by the LDCs is inelastic, and thus the High 5 proposal would have no impact on the behaviour of LDC customers (i.e. the vast majority of customers in the province). Not only does this undermine the effectiveness of any price signals the High 5 proposal is intended to send, but it is also inherently unfair.

8.1.8 In our submission, unless the transmission charge structure can be flowed through to the customers of LDCs, so that those customers also have the opportunity and incentive to respond to the intended price signal, it is not appropriate to implement it. It is, in our view, not fair to load additional costs on ratepayers like schools, small businesses, and residential homeowners, if the basis is not cost causality and those bearing the additional cost are not able to manage their load to reduce the cost. In short, if the intention is to send a price signal, the incented behaviour must be reasonably available to all.

8.1.9 For these reasons, it is submitted that the High 5 proposal should not be approved.

9 GREEN ENERGY PLAN

9.1 *Amounts and Details of the Plan*

9.1.1 ***General.*** Over the course of the proceeding, the approvals requested with respect to the Green Energy Plan evolved. At the end of the day, the approvals are two-fold:

(a) "Conceptual" approval of the plan without most of the spending details; and

(b) Approval of the planned spending on two Schedule A and several Schedule B projects.

9.1.2 ***Conceptual Approval.*** The Applicant was not able to articulate with any clarity what value would be achieved by the Board reaching a decision on whether the Green Energy Plan is "conceptually" sound. The conceptual basis of a Green Energy Plan is set out in the relevant legislation, and the Board's guidance in EB-2009-0397 and other communications to the industry, so is not really a matter of controversy.

9.1.3 Further, asking the Board to say something like "conceptually, you've got it right", is really somewhat unfair given that "you've got it right" is only really possible, in respect of a plan, if you can't consider what is actually being planned. A plan is about doing things.

9.1.4 In this case, what is actually being planned is unsure at this point. This is not Hydro One's fault, but it is the reality. The projects that will be included in the plan, their timing, their prioritization, and their costs, are all still to be determined. There is little left on which the Board can assess whether the plan is a good one in any sense. There is no current plan. When there is one, the Board will be in a position to assess whether it is a good one, both conceptually and in detail.

9.1.5 Even more important, though, is the danger of "approving" something that is so unclear. What would that approval mean?

9.1.6 Approvals do two things: provide a "go" signal for management to proceed in a particular direction, and form a basis for retrospective assessment of management's actions at some future time.

9.1.7 In this case, there is not sufficient detail in the plan as it remains to know with any clarity what actions management should take once they get this "go" signal. They certainly can't proceed with specific projects. Is there sufficient information for management to develop and implement new projects? Does the Board want its "conceptual" approval to act as permission to go ahead with unknown projects? Clearly not. Any projects, whether in the original plan, or new ones, still would require review and approval before implementation. The Board is not in a position to write a blank cheque for projects that it has not reviewed.

9.1.8 Similarly, if management does take action based on the "approval", how would that approval add anything to the assessment of those actions in the next rate case? Those actions will presumably be assessed (for prudence or otherwise) based on the relevant legislation and the Board's guidance. Would the "conceptual" approval change that, or constitute some sort of binding interpretation of that information? If so, does the record in this proceeding make clear what interpretations are being requested, and how they relate to the statutory and policy information already available?

9.1.9 It is our submission that the danger that the Board's "conceptual" approval will end up have effects that are not intended far outweighs the negligible benefit (if any) to the Applicant of having achieved some type of approval.

9.1.10 ***Partial Approval***. Board Staff, in their Final Argument [page 13], have suggested that it may be possible for the Board to approve the Green Energy Plan in part, as opposed to providing the "conceptual" approval. SEC strongly disagrees with this proposal.

9.1.11 In our submission, the whole point of providing for the filing of Green Energy Plans is to have the Board look in a comprehensive way at the overall set of activities planned by the utility to meet its GEGEA obligations. The essence of a plan, in this context, is an integrated review of possible actions/projects, and a prioritization of those actions/projects based on needs, reasonable budgets, available resources, etc.

9.1.12 Plans usually – and this case is one example - should not be approved "in part". If a plan is not ready for approval, it may still sometimes be possible to approve individual projects on their own merits (see below). It is not good practice, it is submitted, to approve a part of the plan. If the plan needs to be downsized, a new downsized plan should be developed, and that new plan should be approved.

9.1.13 ***Schedule A Projects***. Capital spending is included in the test period for two Schedule A projects. Neither is closing to rate base in the test period, and there is no impact on revenue requirement from these projects. Approval for these projects will be the subject of future Section 92 applications.

9.1.14 Given the foregoing, it is our submission that these projects should be removed from the capital budget, and no approval should be given. Any request for approval is, by the Applicant's own evidence, premature.

9.1.15 ***Schedule B Projects.*** We agree with Board Staff that the need for the Short Circuit Upgrades for Leaside, Hearn and Manby, has already been established in EB-2008-0272, and, subject to our comments elsewhere on spending levels generally, the capital spending on those projects has been justified in the evidence.

9.1.16 With respect to the remaining Schedule B projects, it does not appear to us that the Green Energy Plan or any part of it must be approved for Hydro One to proceed with the planned work. To the extent that those projects affect revenue requirement, the spending needs Board approval for that reason, and they are no different from non-GEA projects. They are simply components of the Applicant's capital budget.

9.1.17 We have no additional submissions with respect to the Schedule B projects other than the three Short Circuit Upgrades.

9.1.18 ***Conclusion***. For these reasons, SEC submits that no approval is required or warranted with respect to the Green Energy Plan.

9.2 ***CWIP in Rate Base***

9.2.1 ***General.*** While this issue is on the Issues List under the heading Green Energy Plan, in fact the issues arises primarily with respect to the Bruce to Milton project. Hydro One also asked for Accelerated Cost Recovery of CWIP for some green energy projects, consistent with our analysis under Issue 9.1 above, and our analysis below for Bruce to Milton. In our submission there is no justification for providing CWIP in rate base treatment for any green energy projects at this time. If and when further green energy projects are proposed, the Applicant should be free to propose this treatment for specific projects where appropriate.

9.2.2 Our submissions on this point, therefore, focus on Bruce to Milton.

9.2.3 There are two parts to this analysis. First, we look at whether the Bruce to Milton projects comes within the intent of the policy as enunciated in EB-2009-0152. We conclude that it does not. Second, we look at the claim by the Applicant that ratepayers are better off if CWIP is in rate base and ratepayers pay for it before the asset is used and useful. Again, we conclude that the ratepayers are not better off with that option.

9.2.4 ***The Board's Policy.*** The submissions of Board Staff relating to EB-2009-0152 [pp. 18-19 of their Final Argument] cover most of the analysis, and we will not repeat it.

9.2.5 What appears clear to us is that the Board established a policy, based in part on experience in the United States, to recognize that, particularly where a grid is experiencing major changes, there may be projects that are more risky than normal. In those circumstances, the Board left open in the policy the ability to use creative techniques, including allowing accelerated cost recovery, to reduce the risks inherent in those projects.

9.2.6 We agree with the analysis of Board Staff that there are no unusual risks in the Bruce to Milton project, and it is really a typical transmission project of the type that a utility like Hydro One should implement as part of its core business. Not only is it not particularly risky, but at this point any material risk there was is largely gone, and the remaining risks are exactly the risks that Hydro One is routinely expected to manage on a day to day basis.

9.2.7 ***Better for the Ratepayers.*** It appears to us that the Applicant essentially recognized this, and thus tried an alternate approach of claiming that paying for the Bruce to Milton project in advance is better for the ratepayers.

9.2.8 On the face of it, it is difficult to understand how someone could claim that paying for something before you get it is better than paying for it at the time you have it to use (unless, of course, you are offered a discount for early payment).

9.2.9 Those who are of a certain age will remember something called a “layaway plan”, popular in the 50’s and 60’s before the advent of credit cards. People who wanted to buy something expensive would make small payments to the vendor, often weekly, until they had paid enough to acquire the asset. The sale was not completed until the price had been paid. Many a wedding featured a wedding ring purchased on the layaway plan.

9.2.10 Those merchants never claimed that it was cheaper to buy on the layaway plan. Even the average person realizes that, absent a price change, you don’t save money by paying in advance. The layaway plan was a type of forced savings, sort of like a loan in reverse.

9.2.11 In this proceeding, however, Hydro One has made the appalling claim that paying for something in advance is good for you. To back this up, they have trotted out wonderful spreadsheets that show how, on a “present value” basis, it is cheaper to pay in advance than to pay as you use.

9.2.12 Of course, it is contrary to the simple mathematics that payment of the same amount sooner will have a lower present value. That is, in fact, what present value is all about, calculating the time value of money. To say otherwise is to assume that the Board has never seen a present value calculation before.

9.2.13 So how did Hydro One manage to make a spreadsheet produce the sought after benefit? Several intervenors twigged to the reason, and in multiple cross-examinations the true came out. The use of a low discount rate in the calculation implicitly assumed that the cost of capital for the ratepayers, who were paying earlier, was lower than the cost of capital of the Applicant. Since the Applicant’s cost of capital would go up using the conventional approach, and the ratepayers’ cost of capital would go up using the CWIP in rate base approach, using a lower cost of capital for the ratepayers (i.e. discount rate) ensured that the comparison favoured CWIP in rate base.

9.2.14 This was never actually true. It was games played with spreadsheets, not reality.

9.2.15 The proof of this came in J6.9, when the Applicant showed that if the discount rate used is 7.81% (slightly less than the cost of capital including PILs of Hydro One), the CWIP proposal is no longer "better for the ratepayers". If the discount rate is higher, the ratepayers are worse off.

9.2.16 Common sense, in fact, was right all along (as it so often is).

9.2.17 But that is not the whole story. People who play with spreadsheets often think of the cost of capital as being solely a financial concept, but in the real world that is often not the case.

9.2.18 A residential ratepayer who has higher monthly electricity bills because of increasing utility rates (for example due to proposals like this, or the cumulative effect of many impacts on the bill), will normally not go out and borrow the money to pay the additional monthly cost. If he does, it will typically be at credit card rates, far in excess of 7.81% (and after tax to boot).

9.2.19 But that customer's more likely response is to cut back on other things. The vacation he had planned with his family will be shorter, or to a less favoured destination, or spent at home. The new TV will wait until next year. The piano lessons for one of the kids will be deferred. These are the things that happen in the real world.

9.2.20 For a small business operating close to the breakeven point, struggling to survive, additional costs mean the owner makes less, or the part-time cashier has to be laid off, or, in the worst case, the business simply doesn't survive at all. This is what happens in the real world.

9.2.21 And for a school, there is no option to go out and borrow the money to pay additional electricity costs. A school board has a fixed budget, and increasing electricity bills mean cutbacks in other areas. The new musical instruments for the local high school are no longer in the budget. The school library in a middle school is no longer open during lunch because there is no-one to supervise it. A heritage language program for new immigrants has to be axed. This is the real world.

9.2.22 Clearly all these specific things don't happen because Hydro One wants CWIP in rate base. Thousands of people will not be cancelling their family vacations because of Hydro One. There will not be a wave of library closings from one end of Ontario to another.

9.2.23 But what will happen, if the request is granted as proposed, is that about $70 million that was in the hands of the ratepayers will move to the Applicant. For the most part, those ratepayers will deal with that by cutting back and tightening their belts. The world will not come to an end. There will, however, be $70 million of consequences over 2011 and 2012. That is undoubted.

9.2.24 Where a utility needs money to operate, those who are getting the service must pay for that, one way or another, or stop using the service. The same is true with any business.

9.2.25 But, where the utility does not in fact need the money, but wants it and tries to convince the Board that it is good for the ratepayers, it is simply inappropriate for the Board to allow them to take that money from the pockets of the ratepayers.

9.2.26 We therefore ask that the Board reject this proposal, on the grounds that it is not consistent with the Board's policy, and it is most certainly not "better for the ratepayers".

10 OTHER MATTERS

10.1 *Costs*

10.1.1 The School Energy Coalition hereby requests that the Board order payment of our reasonably incurred costs in connection with our participation in this proceeding. It is submitted that the School Energy Coalition has participated responsibly in all aspects of the process, in a manner designed to assist the Board as efficiently as possible.

All of which is respectfully submitted.

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Jay Shepherd
Counsel for the School Energy Coalition