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Our File Number: 74994

By e-mail to Boardsec@oeb.gov.on.ca

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
Suite 2700, P.O. Box 2319
Toronto, ON M4P 1E4

Dear Ms. Walli:

**Re: Hydro One Networks - 2012 Transmission Rate Application
EB-2010-0002**

We enclose the Reply Submissions of Hydro One Networks Inc. in this matter.

Yours very truly,

D. H. Rogers
DHR:AMV:gt
Encl.

c. Intervenors

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This is the reply argument of Hydro One. It is complementary to the oral argument presented on October 7, 2010 by Hydro One to the Ontario Energy Board (“Board”). The intent of this reply is to respond in some detail to the arguments of Board staff and intervenors. The intent is not to summarize or repeat the vast body of evidence which has already been put forth.

Subsequent to the conclusion of the hearing phase and Hydro One’s argument in chief, Hydro One received final argument submissions from Board staff as well as the following intervenors:

- Association of Major Power Consumers of Ontario (AMPCO)
- Association of Power Producers of Ontario (APPrO)
- Brookfield Energy Marketing Inc. (BEMI)
- Bruce Power
- Building Owners and Managers Association of the Great Toronto (BOMA) and The London Property Management Association (LPMA)
- Canadian Manufacturers & Exporters (CME)
- Consumers Council of Canada (CCC)
- Energy Probe (EP)
- HQ Energy Marketing Inc. (HQEM)
- Independent Electricity System Operator (IESO)
- Ontario Power Authority (OPA)
- Pollution Probe (PP)
- Power Workers Union (PWU)
- School Energy Coalition (SEC)
- Toronto Hydro-Electric System Limited (THESL)
- Vulnerable Energy Consumers Coalition (VECC)

The intervenors have raised a large number of disparate issues, many of which were raised by them neither in the stakeholdering effort, the multitude of written interrogatories, nor the oral phase of the hearing. As a result, it is difficult to address many of the issues raised as there is no evidentiary basis on which the Board could base a decision.

The Applicant will do its best to direct the Board to the evidence, where it exists, in the arguments to follow. However, before doing so, Hydro One must comment upon some preliminary issues in response to a few general arguments advanced by intervenors. Hydro One will address the preliminary matters, will summarize some changes to the revenue requirement being requested in light of the evidence in this proceeding, and will then outline its response to specific issues in accordance with the Issues List.

PRELIMINARY ISSUES

Hydro One's Rate Application and Total Bill Impacts

During Hydro One's last transmission rates application EB-2008-0272 and in its last distribution rates application EB-2009-0096, the economic climate was poor. Hydro One acknowledged that those were difficult times in which financial indices were performing poorly, businesses had been closed, jobs had been lost and many were struggling.

In those rate applications, Board staff and many intervenors urged this Board to evaluate Hydro One's rate application against the general economic backdrop, rather than upon the evidence that was before the Board. The implication was that spending on what were otherwise necessary work programs should be curtailed based on the state of the economy.

Fortunately, the economy is now recovering. Nonetheless, Board staff and intervenors again urge this Board to assess Hydro One's rate application, not upon the evidence, but against a new theme of overall total bill impacts upon electricity consumers, most aspects of which are beyond the control of the Applicant and the subject matter of which is outside the scope of this proceeding.

Hydro One recognizes and agrees that the impact upon consumers is an important factor to be considered by the Board. Indeed, the Board is obligated, pursuant to its mandate in section 1(1) of the *Ontario Energy Board Act,* to protect the interests of consumers with respect to prices. However, that is not the sole consideration for the Board. The Board's function is to balance the interest of the electricity system, the utility and the consumer in accordance with its statutory objectives.

Hydro One submits that in doing so, the Board must promote its statutory objectives in the context of its statutory jurisdiction under section 78 of the *Ontario Energy Board Act* to determine just and reasonable rates. In order to do so, Hydro One's current rate application must, in the Applicant's submission, be assessed upon the evidentiary record before this Board in this proceeding, not upon matters external to Hydro One which are beyond its control and have no evidentiary basis in this proceeding.

Hydro One submits that this Board's role is to consider all of the evidence put forward by the Applicant and to determine a revenue requirement which results in just and reasonable rates, including the impact on the ratepayer, emphasizing the impact of transmission rates on the customer's total bill. However, it would be erroneous and contrary to the principles of rate making to artificially suppress rates and curtail necessary capital projects and other programs, simply because there may be other matters, external to Hydro One which also may impact the overall rates charged to customers. The transmission rate is just one aspect of a customer's total bill.

Hydro One is a stand alone public utility with operations structured like any private, for profit corporation. It provides an essential service to the people and businesses of Ontario. Hydro One is legally obligated, regardless of matters external to it or the services it provides (the transmission of electricity), to ensure that it provides a safe, efficient and reliable transmission system that meets the needs and demands of the province. In this context, the function of this Board is to balance the interests of the utility, delivering the necessary service while earning an appropriate rate of return, with interests of the ratepayers who wish to be served at the lowest price possible while maintaining service and reliability.

The Applicant notes that it is not in the customer's long term interest to suppress rates below the level required to maintain the system and provide an acceptable quality of service.

Hydro One submits that its application and various proposals, such as the capital projects proposed, must be assessed based upon the evidence before the Board. If the justification for the project exists and the Board is satisfied with the evidence, then Hydro One submits those projects should be approved. It would be inappropriate to disallow necessary projects simply because consumers may also face increases on other components of their bill, such as the commodity cost.

Hydro One is not suggesting that the impacts upon consumers ought to be ignored. Indeed it has adjusted this proposal in consideration of customer impact issues. An example is Hydro One's proposed costing exception to MIFRS requirements in order to avoid a $200M increase in revenue requirement commencing in 2012 and for each subsequent year. Another example is the absorption of the additional pension costs in 2011 and 2012.

The Company maintains that once the evidence is assessed and a just and reasonable revenue requirement established, the Board can then consider the impact upon consumers. If the reasonable revenue requirement imposes too large a burden upon ratepayers in the Board's view, then it has available to it other mechanisms to determine how and when the revenue requirement should be recovered. To do otherwise is not in accordance with well established rate making principles.

Hydro One notes that on October 27, 2010 the Board announced some initiatives which will soon assess, in a generic fashion, how overall total bill impacts ought to be considered by the Board and other stakeholders in cost of service rate applications. Hydro One supports this initiative and expects to participate fully in the consultation process as it unfolds. Hydro One submits that this generic process is the appropriate venue to address this generic issue, not this transmission rates application.

Overall Reductions Urged Upon the Board

Hydro One is acutely aware that any proposed increases in its work programs, both capital and OM&A, are of concern to the Board and to ratepayers. It is for that reason that Hydro One filed extensive pre-filed evidence, answered hundreds of interrogatories and produced six witness panels to testify during the oral phase of the hearing, including five of the Company's Senior Vice-Presidents.

Despite all of the evidence supporting the need for the increased work programs, this evidence has largely been ignored by the intervenors. Indeed, there was very little criticism or attack upon any specific work programs, save for a few. Instead, Board staff and various intervenors have urged the Board to make arbitrary reductions.

Hydro One has concerns about the approach urged upon the Board.

A fundamental principle of rate making is that a utility is entitled to recover its prudently incurred costs, including a fair rate of return. That ensures that consumers pay for the actual cost of service, rather than rates which are artificially inflated or suppressed. In the Applicant's submission this principle has been ignored by intervenors in this case

Board staff and a number of intervenors, such as BOMA & LPMA, SEC and VECC among others, have largely relied upon various numerical analyses (envelope reductions, reductions to the "minimum" level identified in the business planning process or arbitrary percentages) to support their arguments to reduce the proposed OM&A and/or capital expenditures in 2011 and 2012.

For example, some parties have relied upon an analysis of actual spend versus Board approved over a four year period of 2006-2009 to urge reductions in the test years. BOMA & LPMA urge an approximate $50M reduction in each of the test years in capital expenditures on this basis.

This line of argument completely ignores the evidence which explains the reasons for the variances or increases. For instance, the primary driver for the 2009 and forecast 2010 under-spend in capital expenditures compared to Board approved amounts was the regulatory approval delays for the Bruce to Milton project ($20M and $72M respectively). Hydro One submits that this evidence should not simply be ignored as some intervenors appear to have done.

Similarly, some intervenors have argued for reductions in OM&A and capital spending using a different or alternative approach based on the "minimum" levels of funding developed during Hydro One's business planning process.[1] The argument in these instances is that Hydro One is seeking approval of OM&A or capital expenditures which are a certain percentage (e.g. 5 or 10%) above "minimum levels" and thus, should be reduced accordingly.

These arguments again ignore the evidence describing the Company's rigorous business planning process. There are substantial cost efficiencies and reductions in proposed spending embedded in the requested levels of spending. The process has also assessed the risks inherent in the further reductions which are being urged upon the Board.[2] As Hydro One has said in this case and in previous cases, and as the evidence shows, this line of argument misrepresents the use of "minimum" levels in Hydro One's business planning process. As Mr. Juhn explained, the minimum funding levels are "construed at times to be an acceptable level of investment. And our planning process, in no way ... is this determined on the basis of being an acceptable investment". "In terms of a reference base, the minimum, the only way that it could

[1] Undertaking J2.3, which is an update to Exhibit I, Tab 4, Schedule 29.
[2] See for example Exhibit I, Tab 4, Schedule 39 and Exhibit C1, Tab 2, Schedule 2 Tables 4A and 4B.

be used is that it's really a lower bound. In terms of the risks associated with that, they are severe."[3]

Scant if any attention has been paid by these parties to Hydro One's evidence outlining and justifying the need for the work it is proposing to complete in the test years [e.g. exhibits C1-2-2, C1-2-3, C1-2-4, C1-2-5, D1-2-1, D1-3-2, D1-3-3, D1-3-4 together with numerous interrogatory responses]. Moreover, the witnesses were, save for but a few examples, not challenged on the actual work programs during cross-examination.

Suppressing spending to the "minimum" levels as defined in the planning process would create significant and unacceptable risks for the system. The approach urged by Board staff and some intervenors is not in the best interests of this utility's customers.

Change in Requested Revenue Requirement

During the proceeding, Hydro One readily acknowledged certain appropriate modifications impacting the overall revenue requirement sought by the Applicant. In addition, having reviewed the intervenor arguments, further changes are acknowledged by Hydro One which also impact the requested revenue requirement for the test years. Those changes and associated impacts are summarized below in Issue 1.3.

[3] Transcript Volume 4, pages 109 and 111.

1. GENERAL

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

A summary of Board directives from previous proceedings is found at Exhibit A, Tab 16, Schedule 1.

Generally, there was little comment upon this issue by intervenors and Board staff alike. VECC questioned whether Hydro One had appropriately responded to the Board direction to continue with its key performance indicator development. A few intervenors argued that Hydro One had not appropriately responded to the Board direction to investigate, with the IESO, whether the export transmission service tariff should be changed or the status quo maintained. Hydro One will address these concerns in Issues 2.2 and 6.1 below.

1.2 Are Hydro One's economic and business planning assumptions for 2011/2012 appropriate?

A test year forecast necessarily implies some uncertainty. The question to ask is whether the forecasts were reasonable at the time that they were made and are they still reasonable.

Some intervenors have challenged Hydro One's economic and business planning assumptions and have asked the Board to require Hydro One to update some of its planning assumptions.

The business plan is based on a consistent set of assumptions which guide the overall development of the business plan. It is inappropriate to selectively update economic indicators, ignoring other assumptions that are part of the overall planning process.

The Applicant acknowledges that some planning assumptions may have changed since this application was filed, but there will be puts and takes, increases and decreases.[4] On balance, the overall planning assumptions continue to remain appropriate for 2011 and 2012.

[4] See Exhibit A, Tab 12, Schedule 1 Appendix A and Exhibit I, Tab 1, Schedule 1.

One of the primary business assumptions underlying this application is that Canadian Generally Accepted Accounting Principles ("CGAAP") apply in 2011. For 2012 Hydro One used Modified IFRS ("MIFRS") as defined by the Board in EB-2008-0408. Hydro One has assumed that MIFRS is equivalent to CGAAP, with two exceptions which the Applicant asks that this Board approve:

- That Hydro One be allowed to continue to capitalize, for regulatory purposes, overhead expenditures such as training, CCF&S and line supervision which would not be capitalized using IFRS but which are causally associated with the construction and bringing into service of new capital works; and

- That Hydro One is permitted to establish a new variance account to record gains and losses on tangible and intangible asset sales or losses which result from premature asset retirements.

Hydro One will address the requested variance account below in Issue 6.3 where the other new proposed variance accounts are addressed.

Hydro One has requested the exception relating to continued capitalization of overheads because, to strictly apply MIFRS, will result in an increased revenue requirement of approximately $200M commencing in 2012 and for each subsequent year. This exemption is requested to protect ratepayers from a significant increase in the revenue requirement simply due to an accounting change.

SEC supported Hydro One's request. No other intervenors commented on the issue.

Board staff alone argued that Hydro One's request should not be granted, though staff did correctly conclude that Hydro One's request was based entirely on customer rate impact considerations.

Board staff's recommendation is that the Board should require Hydro One, for regulatory purposes, to adopt MIFRS without exception, resulting in the expensing of many expenditures[5] in accordance with the Board's stated policy in EB-2008-0408 and its clarifying letter of February 24, 2010. As Mr. Fraser stated during his testimony, the impact of adopting this IFRS standard is an estimated ongoing annual increase in the revenue requirement of $200M.[6] Board staff urged that for 2012, Hydro One should record any remaining difference resulting from changing its capitalization policy from CGAAP to MIFRS in a deferral account. Board staff also recommended that the Board require Hydro One to undertake and report on reasonable business measures to reduce the estimated $200M impact.

Board Staff suggest that reasonable business measures should include considerations that go beyond the allocation of costs, including:

- finding ways to reduce the cost of the functions and services themselves: and
- considering alternate departmental configurations to attribute costs directly to capital work that are otherwise treated as costs in common while not increasing organizational costs inappropriately.

Hydro One disagrees with Board staff suggestions and recommendations and asks this Board not to adopt them for the reasons that follow.

Due to an external financial accounting change, the reclassification of expenditures from capital to OM&A will result in an ongoing annual revenue requirement impact of approximately $200M, with a resulting one-time rate increase for ratepayers of approximately 15%. In contrast to LDCs, Hydro One Transmission does not expect to have depreciation or other offsetting rate impacts resulting from the adoption of MIFRS available to mitigate the

[5] The IASB's prevailing IFRS which governs the costing of Property Plant & Equipment, IAS 16.
[6] For example, see Transcript Volume 7, page 69. See also Exhibit I, Tab 1, Schedule 19, part (d).

impact of a change to a MIFRS capitalization policy. Nor does Hydro One have any realistic opportunity to substantially mitigate this impact.

Hydro One submits that the Board is faced with the following options: (i) to reflect the increased revenue requirement of $200M in transmission rates beginning when it adopts MIFRS in 2012; (ii) approve Hydro One's requested costing exception; or (iii) use a deferral account to mitigate the impact for a finite or indeterminate future period.

The Applicant submits that the proposed accounting exception is in the public interest and should be accepted by the Board particularly in light of the repeated concerns expressed by intervenor groups about rises in rates.

If this Board accepts Board staff's recommendation that Hydro One be required to adopt MIFRS in 2012 without the requested exception, Hydro One strongly opposes recording the reclassified 2012 revenue requirement impact in a deferral account. This would merely defer the problem for one year and will exacerbate the problem in subsequent rate periods. Rather, the 2012 revenue requirement should be adjusted now, using the $200M estimate of the impact, with any differences between the forecast and actual revenue requirement impact tracked in a variance account for 2012. Disposition of the audited variance account balance will be sought at the earliest opportunity.

Recording the entire revenue requirement impact of an estimated $200M due to an accounting reclassification in a 2012 deferral account, as suggested by Board Staff, will substantially amplify the rate increase for 2013 and beyond, depending on the recovery period for the account. Hydro One submits that establishing a deferral account to capture the entire impact of the accounting change is simply a deferral of the problem to subsequent rate periods. If the Board is inclined to refuse Hydro One's request for a policy exception, then Hydro One submits that the accounting change should be reflected in 2012 rates.

Regardless of how the Board rules upon Hydro One's proposal, in order to minimize the impact upon ratepayers, Hydro One will continue to work towards mitigating the impact by justifying the maximum allowable classification of expenditures as capital through continued discussion with its external auditor, as it has already done. However, as Mr. Fraser testified, Hydro One does not expect that a significant portion of the remaining $200M cost reclassification can be mitigated in 2012.[7]

As noted above, Board staff also recommend a number of "business measures" which it argues can reduce the impact upon ratepayers. However, Board staff made no recommendations relating to the proposed expenditures for shared services. The implication is that Board staff accepts the Applicant's proposed costs as reasonable when subject to specific review, but is recommending a blanket reduction in these costs to mitigate the $200M impact. It is inconsistent and simplistic for Board staff to then argue that Hydro One remedy the reclassification problem by reducing the cost of the functions and services themselves which Board staff have by implication acknowledged are appropriate.

Board staff also suggested departmental reconfigurations as a possible solution to remedy the impact of the accounting change. As Mr. Fraser testified, changing business processes, for example increasing the use of time sheets, will not solve the problem as it will not increase the attribution of expenditures directly to capital.[8] A similar explanation applies in the case of a departmental reorganization. In general, business measures will not change the substantive relationship between the indirect activity and the capital work, so no mitigation of the issue is achieved.

Hydro One has already taken and will continue to take all reasonable steps to minimize the amount of expenditures that must be reclassified from capital to OM&A under MIFRS. While there may be some additional opportunities to mitigate this impact, it is not reasonable to

[7] Transcript Volume 7, pages 149-50.
[8] Transcript Volume 7, page 155.

suggest or assume that it can be eliminated or even substantively reduced through the business measures suggested by Board staff.

In addition, Hydro One Transmission will not have an offsetting reduction to its increased OM&A expenses [resulting from the reclassification from capital] in its depreciation expenses that most LDC's will experience. This is because Hydro One has used, since its inception, a depreciation methodology which is very close to that as required under IFRS. In other words, if Hydro One used the same depreciation methodology as the majority of LDC's do in accordance with the Distribution Rate Handbook, its forecast depreciation expense in 2012 would be roughly 60% higher (estimated to be $200M). As the evidence explains, the difference between LDCs and Hydro One is based on different depreciation rates. Hydro One uses depreciation rates which reflect the service life of the assets rather than the generally higher rates mandated by the Distribution Rate Handbook. As such, distributors (other than Hydro One) are artificially shielded against much of this impact due to their use of Board mandated depreciation rates.

Hydro One notes that its ratepayers have benefitted and continue to benefit from the depreciation methodology that it uses. Hydro One is now proposing an accounting exception to MIFRS, for regulatory purposes, which is also to the benefit of its customers. Hydro One will continue with its ongoing efforts to mitigate the potential impacts on revenue requirement. At this time, as Mr. Fraser testified, there is a $200M revenue requirement impact each year if the accounting change is implemented.

Hydro One submits that it is in the best interest of the ratepayers that the exemption be granted and asks that this Board allow it.

1.3 Is the overall increase in 2011 and 2012 revenue requirement reasonable?

Table 1 below outlines the requested revenue requirement for 2011 and 2012 as updated to reflect the impact of HST[9], several corrections to the calculation of PILs and the impact of 2010 actual bond issues on the test years long-term debt rates. As a result of these adjustments Hydro One Transmission's requested Rate Revenue Requirement increase is 14.7% and 9.7% in 2011 and 2012, respectively, versus the 15.7% and 9.8% originally requested. This now represents an estimated increase on total customer bills of 1.1% in 2011 and 0.7% in 2012.

M$	**2011**		**2012**	
Total Revenue Requirement [E1-1-1]	1445.5		1547.4	
HST/PST Refund	(7.2)		(10.4)	
PILs Adjustments				
- Apprentice, Co-Op Ed, SR & ED Tax Cr		(1.7)		(1.6)
- ONT Small Business deduction Cr		(0.0)		(0.0)
- CCA Cr Adj		(1.4)		(0.4)
- **Revenue Requirement Impact**	(3.1)		(2.0)	
LTD - 2010 Actual Bond Issues	(2.1)		(2.0)	
Sub-total Adjustments	(12.4)		(14.4)	
Revised Revenue Requirement	1433.1		1533.0	

Hydro One believes that its overall revenue requirement is reasonable in view of the work expected of it. Furthermore, Hydro One expects a further decrease to its revenue requirement once the Board updates the ROE and short term debt rates for 2011.

[9] Please note that the HST impact will change the proposed levels of OM&A, capital expenditures, rate base, depreciation, return on capital and income tax. Any changes to the proposed levels of OM&A and Capital expenditures in the Board Decision in this proceeding will alter the estimated levels of the HST impact. As a consequence, the HST impact will be re-estimated as necessary and will be fully detailed in the Draft Final Rate Order.

Hydro One has concerns about the submissions made by Board staff and various intervenors about the approach the Board should take when assessing Hydro One's work programs underlying its application. The evidence supporting the need for the work has been largely ignored, as is detailed below.

2. LOAD FORECAST and REVENUE FORECAST

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

Hydro One's load forecast is reliable and has a proven track record. Hydro One has utilized the same methodology that was approved in prior Board proceedings EB-2007-0681, EB-2008-0272 and EB-2009-0096 for which there appears to be general acceptance among intervenors.

As noted by the Board in its decision in EB-2009-0096, "Hydro One has a very sophisticated and capable load forecasting methodology".

No intervenor or Board staff challenged Hydro One's load forecast per se. VECC did express concern that the impacts of CDM have not been accurately reflected in the load forecast. In particular, VECC argued that the load forecast did not take into consideration the OPA's revised CDM projection as filed in Hydro Ottawa's rate application EB-2010-0133 which Hydro One notes is not evidence in this proceeding.

VECC in its argument relied upon the CDM energy impact from the OPA, not the corresponding CDM peak impact which is the appropriate comparison to the CDM values used by Hydro One in its load forecast. The OPA's CDM peak impact found in the Hydro Ottawa evidence demonstrates that Hydro One's CDM peak impact used in the load forecast is consistent with the latest information from the OPA.

Hydro One therefore submits that CDM impacts have been appropriately reflected in the load forecast and requests approval of its load forecast as filed.

2.2 Are Other Revenue (including export revenue) forecasts appropriate?

Hydro One's External Revenues

A number of intervenors including VECC, BOMA & LPMA and SEC have argued that Hydro One's forecasts for 2011 and 2012 external revenues are too low and have argued for various adjustments to the forecasts for Station Maintenance and Engineering & Construction revenues, Secondary Land Use revenues and Export (Transmission) Service Credit revenues.

Hydro One believes that the forecasts are appropriate but notes the almost universal concern of the intervenors.

In EB-2008-0272, Hydro One's last transmission rates proceeding, the Board observed that customers should receive the full benefit of external revenues as they are an important offset to the revenue requirement, but recognized that Hydro One should not bear the risk of under recovery because of forecasts which are too generous in nature.

The Board therefore created variance accounts to capture any differences between forecast and actual external revenues.

Hydro One did not propose to continue the variance accounts in this proceeding. However, in light of the concerns expressed by intervenors, Hydro One is agreeable to the continuation of these three accounts (as detailed below in Issue 6.1).

Export Transmission Service Tariff

In accordance with the Board approved settlement agreement in EB-2006-0501, the IESO agreed to conduct a study of the appropriate Export Transmission Service ("ETS")Tariff. In the interim, the status quo tariff of $1 per MWh has been used by Hydro One in its external revenue forecasts for the test years.

The IESO did conduct the study as it agreed to do. The IESO recommendation was that at this time, the status quo should be maintained. Hydro One called an IESO witness panel during this proceeding to explain its recommendation to the Board.

Hydro One has a revenue neutral position on this issue and defers to the expertise of the IESO in determining the proper ETS charge.

Board staff and a number of intervenors have urged the Board to require the IESO to conduct a further study on this issue suggesting that Hydro One had not followed the previous Board direction.

VECC submitted that Hydro One should take a lead role in any further study of the ETS issue that the Board may decide is necessary. Hydro One disagrees.

To the extent that the Board finds a further study is warranted, Hydro One believes that the IESO should continue to take a lead role because the IESO is the entity that understands the operational and electricity market impacts of a change to the ETS tariff, and has access to the data necessary to properly assess these impacts. Hydro One will continue to provide support to the IESO as needed.

3. OPERATIONS MAINTENANCE & ADMINISTRATION COSTS

3.1 Are the proposed spending levels for, Sustaining, Development and Operations OM&A in 2011 and 2012 appropriate, including consideration of factors such as system reliability and asset condition?

The table below summarizes the OM&A expenditures as filed:

Summary of Transmission OM&A Budget ($ Million)

	2011	2012
Sustaining	233.0	243.1
Development	18.2	18.9
Operations	66.3	68.2
Shared Services and Other OM&A	46.9	46.4
Customer Care	1.1	1.2
Property Taxes & Rights Payments	70.8	72.2
TOTAL	**436.3**	**450.0**

Sustaining OM&A

There was either no comment or expressed support for Hydro One's proposed sustaining OM&A budget for the test years. Hydro One submits that these expenditures be approved as requested.

Development OM&A

There was some argument that Development OM&A should be reduced. For example, Board staff suggested that Development OM&A should be reduced because Hydro One had not persuaded staff that "all reasonable reductions" were made in light of reductions made to Development Capital. With respect, that is not the test Hydro One is required to meet. Nor is there a direct correlation between Development OM&A and Development Capital.

As Hydro One explained in its undertaking response, J3.12, Development OM&A is used to fund Research, Development and Demonstration (RD&D) and standards development work to address long term processes and technical issues on the transmission system. These include smart grid development and studies related to the increasing level of distributed generation on the system. On the other hand, Development Capital spending is for work to expand or reinforce the transmission system. A decrease in capital spending to accommodate timing differences for when projects are required has no correlation to the appropriate level of OM&A funding for RD&D, standards development or Smart Grid work in the test years. Hydro One notes that this is another example where the evidence was not seriously challenged, but reductions were still urged upon the Board in argument.

Energy Probe also argued for some reductions in Development OM&A. Energy Probe argued that smart grid development costs should be reduced by 50% from $4M to $2M in each of the test years. CCC argued for reductions of 50% to the overall RD&D and Smart Zone budgets of $10.4M and $10.6M in 2011 and 2012 respectively.

Hydro One submits that reductions to research and development expenditures in the test years are not appropriate. Hydro One has an ongoing research and development program with many partner organizations. Hydro One has proposed nominal increases in spending of $0.4M in 2011 and an additional $0.2M in 2012. Most of this work is accomplished through multi-year investments involving contractual arrangements with universities and organizations like Canadian Electrical Association Technologies Inc., Electric Power Research Institute, Natural Sciences & Engineering Research Council and Ontario Centres of Excellence (“CEATI”, “EPRI”, “NSERC” and “OCE” respectively). The multi-year contractual relationships are required to gain the leveraged funding as well as accomplish the scopes of work for the projects. Cutting expenditures in research and development would jeopardize Hydro One’s capability to assess emerging technologies and make informed investment decisions, and would compromise existing contractual obligations and current projects.

Hydro One notes that specific programs were not challenged. As outlined in evidence[10], the defined projects for RD&D include:

- Monitoring emerging technologies through leveraged participation with industry groups CEATI and EPRI with an example of one project to influence the development of Critical Infrastructure and Cyber Security related standards;
- Implementing pilot projects to confirm viability of new technologies and products before widespread deployment on the transmission system, including a project on effective deployment strategy for Phasor Monitors;
- Improving the design, operation and maintenance practices including the development of better risk assessment tools, with an example project on Dynamic Transformer Rating; and
- Partnering with universities to perform RD&D and develop undergraduate and graduate students as potential future employees for Hydro One, including leveraging funding with the NSERC for grants awarded to research associates.

Hydro One submits that these ongoing research and development projects and associated expenditures are reasonable and asks that the Board approve them.

As noted above, Energy Probe urged reductions in costs for Smart Zone development. Hydro One submits that it would be imprudent to do so. There has been a surge of interest and activity related to Smart Grid across the North American utility industry, as well as in Europe and China. This work is necessary to test equipment that will be required for advanced communication between transmitters, generators and LDCs. This will facilitate LDC activities to create a Smart Grid in the distribution system and will allow for the connection of increasing amounts of distributed generators. Work on the transmission system to accommodate these changes is necessary.

[10] Exhibit C1, Tab 2, Schedule 4, pages 3-5.

The Smart Zone Development OM&A expenditures are detailed in the pre-filed evidence.[11] This work supports Smart Zone capital investments and also includes:

- Piloting new technologies
- Piloting the next generation intelligent electronic devices
- Examining implications and maximizing the utility of large scale integration of solar photovoltaics

These activities are all aimed at the transmission impacts of supporting the Smart Zone in the Owen Sound area. Hydro One submits that the Board should approve the proposed expenditures in the test years to ensure that this important work continues.

Operations OM&A

The proposed spending for Operations OM&A was carefully reviewed through the business planning process and reconsidered prior to filing of this application. This spending is reasonable and is required to meet the Company's goals and objectives. Specifically, the proposed spending is necessary to ensure that system needs and reliability are sustained.

Akin to the comments made regarding Development OM&A, Board staff's opinion is that Hydro One failed to demonstrate that reductions to Operations OM&A programs were properly considered. As noted above, that is not the onus placed upon the Applicant. Hydro One submits that Board staff's analysis fails to identify any proposed expenditures which in staff's view are inappropriate, imprudent or unsupported by the evidence.

As outlined in the pre-filed evidence and during the oral hearing, the primary driver for the increase in Operations OM&A between 2009 and 2011 is the ongoing effort and expense

[11] Exhibit C1, Tab 2, Schedule 4, pages 6-7.

required to support the 2009 end of life replacement of the entire Network Management System, which is necessary to monitor and control the Hydro One grid. [12]

As Mr. Tremblay testified, two of the primary drivers for these higher cost levels are "increased licensing costs that go with the [new] software, predominantly for the cyber-security component of it, and … the overall system grew to the point that the [IT] architecture that we use went under a different licensing structure … and that carried increased costs as well." [13] Mr. Tremblay also explained that when reductions were made in the spring of 2010 to Sustaining and Shared Services OM&A costs, Operations costs were also reviewed. However, as Operations costs are "driven … by maintaining the existing system, so we are not able to cut back on that. And … we're still actually understaffed in terms of our demographics and hiring, so again … we didn't feel that we could cut back on that as well."[14]

Hydro One submits that the evidence demonstrates that the proposed increased expenditures are necessary. Moreover, Hydro One did review Operations OM&A to determine whether reductions could be made, but exercised its judgment and determined that it could not be prudently done.

Energy Probe challenged Hydro One's proposed marginal increase in Operations – Environmental, Health and Safety by $1M. Energy Probe's view is that the Company's current safety program is effective based on its safety record and consequently it is good enough.

Hydro One submits that Energy Probe has failed to recognize that historical improvements in its safety record would not have occurred had the necessary investments to improve safety not been made.

[12] Exhibit I, Tab 1, Schedule 44; Exhibit C1, Tab 2, Schedule 5, page 3.
[13] Transcript Volume 4, page 130.
[14] Transcript Volume 4, page 131.

Mr. Marcello explained that the relatively small increase in absolute terms in expenditures is to initiate Hydro One's new "Journey to Zero" initiative. The goal of that program is "driving a culture where we will see zero workplace injuries. … While our performance is respectable against CEA benchmarks, our feeling is that there should be no workplace injuries, no workplace fatalities." [15] In addition, the program is needed to ensure that all of the new employees recently engaged by Hydro One learn the best safety practices as they enter the workforce.[16]

Moreover, work efficiency gains are also anticipated with enhanced safety programs as Mr. Marcello testified based on the experience gained by industry leaders in workplace safety:

> "One of the external companies we have brought in to help guide us in this area is Dupont and companies associated with implementing their methodology and their philosophy. They are largely viewed as the industry leader.
>
> And one of the things that was very compelling in their discussion is that, as you implement the culture of safety, you will start to see over time benefits that you didn't count on. Planning your work better results in more effective and efficient execution of that work. … We have brought this plan forward for safety reasons, not for operational, but others are saying that good processes in the safety area pay broader dividends."[17]

Hydro One submits that the proposed spending is prudent based upon its goals and objectives and requests that the Board not consider any reduction in this area.

[15] Transcript Volume 4, page 21.
[16] Transcript Volume 4, page 25.
[17] Transcript Volume 4, pages 26 and 27.

Cost Effectiveness Measures

In support of its argument for envelope reductions in OM&A, Board staff commented upon cost effectiveness.

Board staff asserted that the evidence indicates a deterioration in performance on OM&A cost measures, while Hydro One's transmission system performance measures remain above average. On that basis, Board staff question whether costs could be reduced without noticeably reducing system performance. VECC similarly submitted that Hydro One is not demonstrating improved operational productivity performance as its Transmission Unit Cost (TUC) metric rises and that the Board should take this into consideration when deciding on the appropriateness of reductions in compensation.

Board staff appear to have misinterpreted the evidence regarding unit cost metrics and system performance metrics. Specifically, Board staff have examined metric numeric values in isolation and have not considered them in conjunction with the analytical evidence which has been filed.

In the 2006 to 2012 period, there has been a gradual rise in the volume of both Sustaining OM&A and capital work including end of life (EOL) replacements and mid life overhauls. The costs associated with these work programs have increased as a result. The increases in work have been and continue to be driven by asset aging and asset condition. An expected consequence of this vital work is that unit cost metrics such as Transmission Unit Cost (TUC) rise through this period.

As outlined in evidence, in the 2011 and 2012 test years, additional work is necessary for a variety of well documented reasons, including meeting new PCB regulations, NERC requirements including cyber security as well as protection, control, monitoring and telecommunications EOL replacements.

Hydro One provided 2006 to 2012 data for OM&A per Gross Fixed Assets [OM&A per GFA] and OM&A per line kilometre metric [OM&A per km].[18] The former metric declines by about 5% over the test years. However, Board staff focus upon the latter metric, which increases by the same percentage over the test years.

In Hydro One's view, the OM&A per GFA provides a more appropriate high level view than the OM&A per km metric. Specifically, the denominator of the OM&A per GFA metric includes all types of assets, ranging from station transformers to overhead lines; whereas the OM&A per km metric only includes line circuit kilometres in the denominator. The difficulty is that the numerator for both of these metrics includes OM&A spend on all assets. A large portion of the increased OM&A spend is in the stations area, to meet new Environment Canada PCB regulations and NERC cyber security requirements for example, which bear no direct relationship to line circuit kilometres. High level measures of this type are useful to provide an overall indication, but must be assessed in the context of the details that are used to derive the measure.

Though some of Hydro One Transmission's system performance metrics are better than 2007 CEA averages, Hydro One is concerned that in a number of instances, the performance of its equipment is below CEA averages. Hydro One's position is that further reductions in the requested funding will impact system reliability and, as a consequence, quality of service. A decline in quality of service imposes real costs on the utility's customers.

3.2 Are the proposed spending levels for Shared Services and Other O&M in 2011 and 2012 appropriate?

A number of intervenors such as Energy Probe, AMPCO, PWU and Board staff either supported or had no comments about Shared Services OM&A. VECC noted that the CCF&S expenses were "reasonable", but claimed there was no "constraint" applied by the Applicant

[18] Exhibit I, Tab 1, Schedule 37.

and thus should be reduced. Only CCC and VECC urged a reduction to Shared Services OM&A related to a particular area of spending.

In the absence of any evidence or argument that these proposed expenditures for Shared Services and Other OM&A are not prudent or otherwise reasonable, Hydro One submits that these expenditures be approved as requested.

As noted, CCC urged a specific reduction to the General Counsel and Corporate Secretariat services on the basis that these expenditures should be reduced by 50% as Green Energy Plans are slowing down.

Hydro One disagrees.

Some of the proposed expenditures for this shared service relate to work associated with green energy initiatives. However, the majority of the increased activities relate to the larger work program generally. This includes more procurement work, review of legal agreements associated with distributed generation and real estate related work to obtain land and land rights for new projects, some of which are green energy projects, but are still required within the current work program.

Hydro One notes that in EB-2008-0272, the Board approved transmission allocated costs for 2009 and 2010 were $4.5M and $4.6M respectively. In 2011 and 2012, Hydro One's proposed costs allocated to transmission for this function are $4.8M and $4.5M respectively. The 2011 increase is due to the Records Management Project which ends in 2011. The amounts proposed are consistent with previous Board approved spending levels.

VECC argued that the Board should reduce Hydro One's proposed OM&A spending on Corporate Communications in 2011 and 2012 by $5M in each of the test years due to GEGEA related activities. However there is no increase in spending in 2011 in this area. A $5M increase is proposed for 2012.[19]

Hydro One expects that the OPA will complete the ECT and issue the new Long Term Energy Plan sometime in 2011. The development work on priority projects will resume at that time. Hydro One anticipates that the $5M increase as a result of additional work requirements to support the GEGEA projects in 2012 will be required. The additional work requirements that will be funded include coordination with energy agencies (OPA, IESO), the Ministries of Energy and of Environment and internal groups within Hydro One. Initiatives to be coordinated include preparation of risk assessments, provision of strategic direction, participation in pre-public consultations with municipalities and First Nations, representation of Hydro One on external working groups, and development and negotiation of partnership arrangements.

In light of the anticipated resumption of Green Energy projects, Hydro One submits that the forecasted level of spending is appropriate and no reduction is warranted.

BOMA & LPMA argued that Hydro One should establish a variance account for unexpected and non-recurring costs in the "Transmission Other costs" category, and that Hydro One should be required to forecast these amounts.

Hydro One disagrees.

By definition, these costs are not expected and do not recur. It is difficult to see how Hydro One could forecast these amounts with any degree of reliability or at all. Moreover, Hydro One notes that when looking at its historical <u>overall</u> OM&A costs, the company has been relatively accurate in its forecast. BOMA & LPMA's suggestion should be rejected.

Hydro One therefore asks that no reductions be made to Shared Services and Other O&M.

[19] Exhibit C1, Tab 2, Schedule 7; Exhibit I, Tab 10, Schedule 13.

3.3 Are the 2011/12 Human Resources related costs (wages, salaries, benefits, incentive payments, labour productivity and pension costs) including employee levels appropriate? Has Hydro One demonstrated improvements in efficiency and value for dollar associated with its compensation costs?

Hydro One is well aware of the concerns that this Board has previously expressed about its compensation costs in its recent rate applications. The Board has urged the Company to take action to control both compensation expenditure increases and growth in head count.

Hydro One has done so, to the extent that it can, in light of the collective agreements for both PWU and the Society which remain in place.

As the Hydro One witnesses testified, new measures adopted since its last distribution rate case EB-2009-0096 include adopting the government's net zero wage increase policy for all of its management staff, continued use of a flexible labour staffing strategy and the introduction of new lower level wage positions.

Mr. Goldie explained that reductions in overall compensation cannot be achieved in the short term. Reductions in overall compensation occur slowly, over time. Furthermore, it is important to appreciate that it is extremely difficult to decrease labour costs through the collective bargaining process and through a reduction in wages alone. As Mr. Goldie pointed out and as described in prefiled evidence[20], Hydro One simply could not withstand a prolonged PWU strike and an arbitrated agreement would likely not produce any wage reductions. In the event of a strike, consumers would experience extended power disruptions within a very short period of time. Hydro One's strategy, is to reduce labour costs through others means over which it has more control, such as MCP staff salary freezes and the utilization of a lower cost temporary workforce.

[20] Transcript Volume 5, Page 19 and Exhibit C1,Tab 3, Schedule 2, page 4

Hydro One is well aware of the labour cost issue and will continue with its efforts to achieve productivity gains and overall compensation reductions during its next labour negotiations with both the PWU in 2011 and the Society in 2013.

The Board disallowed $4M in compensation costs in the last transmission rate proceeding EB-2008-0272 with a similar reduction in the last distribution case EB-2009-0096 (contained within an overall OM&A reduction). Since then, the compensation reductions outlined above have been implemented.

Hydro One submits that similar reductions are not appropriate in this case and serve no useful purpose. The Company has understood the Board's message. Efforts have been made to promote savings where it has been in the Applicant's ability to do so. Further reductions would, in the Applicant's respectful submission, merely be punitive.

Moreover, any reduction will not achieve what presumably is its purpose. Hydro One must pay its work force in accordance with the existing legal, binding collective agreements and compensation plans. A Board ordered reduction in allowed compensation expense does not result in actual reduced compensation costs in practice. Such reductions, in reality, mean reductions in necessary work programs, which is not in the interest of the transmission system, the ratepayers or the utility.

Head Counts

VECC and SEC expressed concern over increasing headcount and recommended reductions to compensation on that basis. VECC argued that in addition to general reductions in compensation, a further reduction of $3.75M in each of the test years was warranted assuming disallowance of 50 full time equivalents (FTE's) with an assumed base salary of $75k each. SEC was critical of the company for not providing compensation information on the basis of FTE's and due to increasing headcounts.

There appears to be, as has been the case in prior proceedings, either a fundamental misunderstanding on how Hydro One plans its staffing needs or perhaps simply a refusal to accept it.

As explained in the pre-filed evidence and during the oral portion of this proceeding, the headcount tables filed in evidence are not directly tied to the revenue requirement that the Applicant it is seeking. The headcount information provided is for Hydro One Networks which includes staff who perform work for both the Networks Transmission and Distribution businesses. As such, headcount tables have been provided for illustrative purposes only.

Hydro One's planning process is a work based process. The work program is established first. This in turn determines the quantity of staff that will be required in order to execute the work program. In other words, the work program drives the headcount, not vice versa. Thus, if Hydro One is directed by this Board not to proceed with certain work programs, then the staffing levels will be adjusted accordingly. As Mr. Goldie testified, the staffing levels can and will be adjusted without any cost consequence due to the flexible nature of the workforce (42% of which can be eliminated immediately with no adverse cost consequences).

Accordingly, Hydro One submits that it is not appropriate for this Board to reduce OM&A expenditures based on headcount alone.

Retirements

Some intervenors suggest that Hydro One does not need to hire now because employees are not retiring at the rate anticipated. Hydro One notes that retirements are in fact increasing. In 2004, 395 employees were eligible to retire.[21] By 2012, 1600 employees will be eligible to retire.[22] Mr. Goldie emphasized that the problem is very real and if Hydro One does not do

[21] Exhibit J5.3
[22] Exhibit I, Tab 2, Schedule 21

anything to deal with it now, then Hydro One will face a very serious shortage of skills in the future.[23]

Pension Costs

Board staff and intervenor arguments focused on employee contributions to the pension plan and the recent pension valuation and performance.

Board staff argued that Hydro One should, in the collective bargaining process, consider an increase in the employee contribution share towards the pension plan costs. Hydro One will of course explore any gains that can be achieved in the bargaining process. It has already done so for the employee funded portion of the pension plan in the current collective agreement with the Society.[24] The current agreement with the Society includes a provision where employee contributions to the pension plan increase 0.5% if the pension assets fall below 106% of the liabilities upon a solvency valuation. In light of the recent pension valuation, this provision was triggered.

Board staff raised a concern with the recent performance of the plan which was ranked at the 61st percentile. Hydro One continues to take steps to improve performance of the pension plan. Hydro One monitors the performance of its managers of the plan and replaces any that are unable to meet the mandate for which they were hired.[25] In addition, as Mr. Struthers testified, Hydro One has replaced five of the twenty two managers in 2010 as part of its ongoing review process.[26]

In its argument, Board staff invited Hydro One to clarify the impact of the recent pension plan valuation.

[23] Transcript Volume 5, page 98
[24] Exhibit I, Tab 7, Schedule 14, Attachment 2, page 32.
[25] Exhibit I, Tab 2, Schedule 54, part (e).
[26] Transcript Volume 7, pages 138-39.

Hydro One's initial forecast pension costs were $114M in 2011 and $118M in 2012. Of these amounts, approximately $29M in 2011 and $30M in 2012 were allocated to Transmission OM&A.[27]

Mercer performed the most recent valuation of the pension plan which was filed with the Financial Services Commission of Ontario in September 2010. The valuation results indicated that Hydro One will have to contribute approximately $139M into the pension plan starting in 2010 and continuing in 2011 and 2012.[28] Thus, as a result of the recent valuation, the actual annual Transmission OM&A pension cost for 2010 is now approximately $5M higher than initially was forecast to be the case. This additional amount for 2010 will be recorded in the Board approved variance account for review and disposition in a subsequent proceeding.[29]

Using the same formulae initially used to estimate the Transmission OM&A portion of pension costs for 2011 and 2012 and based on the new valuation, the Transmission OM&A pension cost amounts for the test years will increase by approximately $6.4M and $5.3M respectively.

Hydro One has not requested corresponding increases in its Transmission OM&A.

As stated in the evidence, Hydro One will absorb these known increased costs resulting from the valuation as a rate mitigation measure in the test years. Hydro One does propose to book any actual volume variance differences from the new forecast pension costs to the existing variance account.

Accordingly, as noted by Board staff, there is no rate impact during the test years due to the revised valuation.

[27] Exhibit C1, Tab 3, Schedule 2, Appendix A
[28] Exhibit I, Tab 1, Schedule 60
[29] Transcript Volume 7, pages 100-101

Cost Efficiencies

Hydro One's evidence in this proceeding has identified OM&A cost efficiencies of about $34M in 2011 and $43M in 2012, and capital expenditure savings of about $38M and $46M respectively, through a variety of initiatives including:

- Cornerstone savings of $12.5M and $21.5M in OM&A and $9.5M and $15.9M in capital through the implementation of Phases 1 to 3.
- Strategic sourcing savings of about $15M and $16M via bulk purchases of major commodities such as auto transformers, power transformers, conductor and circuit breakers.
- Outsourcing savings with a reduction of Development capital expenditures of about $10M and $12M.
- Due to process efficiencies, a 1% reduction in Supply Chain Management costs between 2010 and 2012.
- Reduced annual telecom lease costs and payback on the Telecom Wide Area Network implementation within five years.
- Process and operational efficiency gains at the Ontario Grid Control Centre (OGCC) via implementation of the Telemetry Expansion Program. This will help reduce unnecessary equipment outages and removals of equipment from service and unnecessary callouts of field staff to stations.
- Streamlining of the outage planning process at the OGCC through implementation of the integrated Operations Support Tools package within the Network Outage Management System.

Hydro One submits that it has demonstrated a number of cost efficiencies through a variety of measures.

Energy Probe challenged some of the cost efficiencies identified in Hydro One's evidence. For example, Energy Probe argued that the cost efficiencies which can be extracted from new systems, such as Cornerstone, NOMS and NAMS should be disregarded because the increased annual costs associated with the system exceed the efficiencies gained. This argument ignores the original need for the systems to replace obsolete systems and that the costs, including ongoing annual costs, were going to be incurred in any event. It is inappropriate in Hydro One's submission to ignore the secondary cost efficiencies that the new systems facilitate.

Energy Probe's assertion that "some of the newer initiatives might actually reduce cost efficiency by introducing more costs than they save" lacks merit. For instance, the fleet cost efficiency initiatives outlined in J4.1 all clearly provide net savings which are to the benefit of ratepayers.

3.4 Are the OM&A development costs allocated to the "IPSP and Other Preliminary Planning Costs" deferral account for 2009, 2010, 2011 and 2012 appropriate?

Hydro One is proposing to recover $2M which has accrued in this account for 2009 as detailed below in Issue 6.2.

As explained by counsel when clarifying what is being sought in relation to the Green Energy Plan, Hydro One is not asking for any other recovery in relation to this account that would impact the revenue requirement in the test years. Hydro One expects to come before the Board in future rate proceedings to seek recovery of any further account balances which have accumulated in 2010 and beyond. At that time, both the Board and intervenors can test the reasonableness and prudence of the amounts proposed to be recovered.

3.5 Are the methodologies used to allocate Shared Services and Other O&M costs to the transmission business and to determine the transmission overhead capitalization rate for 2011/12 appropriate?

Hydro One's methodologies to allocate shared service and other costs and to determine the overhead capitalization rate are consistent with the methodologies previously reviewed and approved by the Board in prior proceedings.

Board staff and intervenors do not appear to have any concerns with the methodologies used.

Hydro One asks that this Board approve its methodologies used to allocate Shared Services and Other O&M costs and to determine the transmission overhead capitalization rate. Should the Board not approve the Applicant's proposal for the IFRS costing exception outlined above in Issue 1.2, the transmission overhead capitalization rate methodology for 2012 will need to be adjusted materially.

3.6 Are the amounts proposed to be included in the 2011 and 2012 revenue requirements for income and other taxes appropriate?

Income Taxes

Few issues were raised relating to Hydro One's income tax calculations. BOMA & LPMA were the primary intervenors which had arguments relating to this issue. BOMA & LPMA generally observed that Hydro One's income tax calculations were appropriate, save for three exceptions:

a) <u>Apprenticeship, Co-op Education and SR&ED Tax Credits:</u> Hydro One is in agreement with the BOMA & LPMA submission to increase the tax credit forecast from $2.2M in each of 2011 and 2012 to $3.9M in 2011 and $3.8M in 2012.

b) Ontario Small Business Deduction: BOMA & LPMA have calculated the impact of the Ontario small business benefit to be $36,250 for 2011 and $33,750 for 2012. Hydro One agrees that this benefit is available to it. However, when allocated amongst the Hydro One companies, the benefit is $11,689 for 2011 and $10,883 for 2012 for the Transmission business.

c) CCA Changes: Hydro One agrees that the updated CCA calculations provided in Exhibit I, Tab 6, Schedule 24, for 2010, 2011 and 2012 should be used for the deductions in 2011 and 2012.

These amounts have been reflected in the revised revenue requirement sought by the Applicant.

Other Taxes: Property Tax and HST

BOMA & LPMA agreed that Hydro One's forecasts for an increase in property taxes of $1.4M in each of the test years was reasonable, however took exception to the projected increase for property taxes of $2.1M to $60.4M from the actual property taxes paid in 2009 of $58.3M.

Hydro One explained in the pre-filed evidence that it annually reviews the Notice of Assessment it receives and appeals any incorrect classifications or over-valuations.[30] There was no cross-examination on this process or the outcomes. Had there been, Hydro One would have explained that its actual property taxes in 2009 were $59.3M, but a one time credit of $1M was received in 2009 from tax appeal processes.

Hydro One submits that its forecast property taxes are appropriate and that no adjustment is warranted.

[30] Exhibit C1, Tab 2, Schedule 13, page 3.

Several intervenors submit that the cost impact between the HST and the PST should be reflected in the revenue requirement for the test years, with the difference tracked in a variance account.

Hydro One is prepared to reflect the cost impacts between HST and PST in the revenue requirement as previously noted. Therefore, a deferral account is no longer warranted.

Similarly, a variance account is not appropriate in these circumstances. A variance account would only be useful if Hydro One can determine the auditable difference between the estimate and the actual impact. Hydro One is unable to do so due to the fundamental difference between the PST and the HST and the significant volume of transactions which are impacted.

Mr. Fraser stated in evidence that Hydro One would appreciate an opportunity to refine the estimates of $5.2M in OM&A for 2011 and $5.3M in 2012[31]. Since the oral hearing, Hydro One has been able to do some further analysis of the reduction to the revenue requirement driven by the harmonization of the GST and PST. Hydro One has revised its estimates of the impacts to be $7.2M and $10.4M in 2011 and 2012 respectively. The revised impact is due to reductions in OM&A, depreciation, and return on rate base, together with an increase in income tax.

These updated estimates are premised upon Hydro One's pre-filed evidence. These estimates may change pending the Board's decision in this proceeding.

Hydro One has reflected these revised estimates in its revenue requirement for the test years.

[31] Volume 7, page 74

3.7 Is Hydro One Networks' proposed depreciation expense for 2011 and 2012 appropriate?

Hydro One's calculation of the depreciation expense was not challenged by intervenors or Board staff. Hydro One will update its depreciation expense to reflect the Board's decision in the final rate order.

4. CAPITAL EXPENDITURES and RATE BASE

4.1 Are the amounts proposed for rate base in 2011 and 2012 appropriate?

Hydro One submits that the amounts proposed for rate base in the test years are appropriate as explained in the submissions that follow.

BOMA & LPMA raised some specific concerns relating to rate base.

Materials/Supply Inventory

BOMA & LPMA submit that Hydro One has a poor track record in forecasting its level of materials and supplies inventory.

Hydro One disagrees and submits that this criticism is unfounded.

As noted in the pre-filed evidence, effective January 1, 2008, the Company retrospectively adopted Canadian Institute of Chartered Accountants' (CICA) Handbook Section 3031, Inventories, which required that certain major spare parts and standby equipment be reclassified from inventory to fixed assets. The evidence included the reclassification of comparative prior period amounts. [32]

[32] Exhibit D1, Tab 1, Schedule 4

The previously Board approved amounts for materials and supplies inventory were $36.7M in 2009 and $38.7M in 2010. These approvals were based on the old CICA standard for inventory. The actual inventory for 2009 of $11.7M and the projected inventory for 2010 of $12.7M reflects the adoption of Section 3031 of the CICA Handbook which saw significant amounts previously classified as inventory being reclassified as fixed assets.

Accordingly, Hydro submits that the forecast amounts are appropriate.

In addition, BOMA & LPMA argued that Hydro One's forecast amounts for 2011 and 2012 for materials and inventory (increased over prior years) are not justified. Hydro One disagrees. Hydro One recognizes that the forecasted amounts for the test years reflect a large increase over historical levels, but submits that the proposed increases have been fully explained in the pre-filed evidence, and were not challenged in cross-examination. In particular, increases are due to:

- the growth in the transmission work program;
- an increased transmission asset base;
- a large percentage of the asset base entering its mid-life to end-of-life age demographic, resulting in an increase in installed assets, which requires additional materials and supplies inventory, and
- a need to replenish materials and supplies inventory where numbers are low.[33]

[33] Exhibit D1, Tab 1, Schedule 4.

It is clear that the increases in Materials/Supply Inventory levels are driven by growth in the transmission work program throughout the historic and test periods, and in particular the Sustaining program which is demonstrated by the ratio of year end inventory to the sustaining capital program as shown in the table below:

$M	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
YE Inventory	10	11	12.3	13.1	21.7	26
Sustaining Capex	142.7	223.9	224.1	241.8	337.3	357
Inventory/Capex	7.0%	4.9%	5.5%	5.4%	6.4%	7.3%

For the reasons outlined above and explained in the pre-filed evidence, Hydro One submits that the forecast for materials/supply inventory is appropriate and requests that this Board so find.

4.2 Are the proposed 2011 and 2012 Sustaining and Development and Operations capital expenditures appropriate, including consideration of factors such as system reliability and asset condition?

Outlined below in Table 2 is a summary of the capital expenditures for 2011 and 2012 for which Hydro One seeks approval:

Summary of Transmission Capital Budget ($ Million)
Including Capitalized Overheads and AFUDC

	2011	**2012**
Sustaining	424.0	443.4
Development	617.2	456.8
Operations	44.3	57.4
Shared Services Capital	66.3	50.6
TOTAL	**1,151.8**	**1,008.3**

As observed in the preliminary comments above, there was generally (aside from Green Energy related matters), little criticism of specific work programs. In fact, Energy Probe, PWU and Board staff supported or had no concern with the proposed Sustaining, Development and Operations capital expenditures.

Concerns were raised about the Green Energy related capital projects, which will be discussed in Issue 9.1 below.

Hydro One submits that the evidence, combined with a lack of any meaningful specific criticism from intervenors and Board staff, demonstrates that the proposed capital expenditures are appropriate, and that they ought to be approved as requested.

4.3 Are the proposed 2011 and 2012 levels of Shared Services and Other Capital expenditures appropriate?

The proposed levels of Shared Services and Other Capital expenditures are appropriate. No specific concerns were identified by intervenors or Board staff. Hydro One submits that the proposed expenditures for 2011 and 2012 be approved as requested.

4.4 Are the methodologies used to allocate shared services and other capital expenditures to the transmission business, appropriate?

Hydro One has applied the methodology approved by the Board in previous proceedings.

Generally, there was either support or no comment about the methodology used to allocate Shared Services and Other Capital, and thus, Hydro One asks that the methodology again be approved by this Board.

4.5 Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

The methodology being followed by Hydro One in this case has been accepted by the Board in previous proceedings. Hydro One will reflect the Board's decision on the impact of the change to the HST on revenue requirement in its final working capital calculations for the test years.[34]

4.6 Does Hydro One's Asset Condition Assessment information and Investment Planning Process adequately address the condition of the transmission system assets and support the O&MA and Capital expenditures for 2011/12?

Hydro One expanded the information on its investment planning decision process and asset condition in this proceeding. The evidence filed in this case was far more comprehensive and extensive in support of its Sustaining programs.

Quite unlike past proceedings where Hydro One's asset condition assessment and its investment planning has generated a good deal of attention, in this proceeding, there was little if any discussion about it.

Hydro One has a thorough asset condition assessment process and engages in a thorough and rigorous business planning process that supports its future investments.

It is ironic to Hydro One that many intervenors urge reductions in work programs, yet did not challenge, and impliedly accepted, the asset condition analysis and project justifications based upon it.. These arguments are inconsistent with the uncontested evidence.

Hydro One submits that the only reasonable conclusion that the Board can reach on this evidentiary record is that the Company's Asset Condition Assessment information and Investment Planning Process adequately address the condition of the transmission system assets and support the proposed capital and OM&A expenditures in the test years.

[34] The current estimate of the HST impact on revenue requirements includes the impact on working capital.

5. COST OF CAPITAL/CAPITAL STRUCTURE

5.1 Is the proposed capital structure appropriate?

Hydro One's deemed capital structure is 60% debt (56% long term and 4% short term) and 40% equity. This is consistent with both of the Board's reports on the cost of capital: see Report of the Board on the Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors dated December 20, 2006 in EB-2006-0088/EB-2006-0089 and the recent Report of the Board on the Cost of Capital for Ontario's Regulated Utilities dated December 11, 2009, EB-2009-0084.

Hydro One submits that the proposed capital structure is appropriate.

5.2 Is the proposed timing and methodology for determining the return on equity and short-term debt prior to the effective date of rates appropriate?

Some intervenors have argued that Hydro One should forego or be denied its fair return on equity in light of the proposed rate increases.

This argument ignores the long established finding of this Board and other regulators that a fair rate of return is a true cost to the utility. The Supreme Court of Canada has upheld this fundamental principle of rate making. A Board decision depriving the utility of its appropriate regulated rate of return can negatively impact its credit rating and impact its ability to borrow funds at reasonable rates.

Furthermore, Hydro One submits that it would be an error in law to deny the Applicant its fair rate of return.

Hydro One will, as in prior proceedings, recalculate its ROE in accordance with the Board's report once it receives the updated cost of capital parameters from the Board which will reflect updated information from the September consensus forecast.

Hydro One anticipates that the ROE that will be reflected in the final rate order following receipt of the Board's decision will be lower than that reflected in the pre-filed evidence due to changes in economic forecasts.

As a final comment, Hydro One notes that similar arguments to deny or reduce its fair rate of return were made in EB-2009-0096. In rejecting the arguments made by intervenors, the Board stated:

> "…parties wishing to challenge the application of the Guideline in whole or in part to any given utility have an obligation to file evidence supporting their point of view. That burden properly rests with the party seeking to displace the operation of the Guideline. Argument, unsupported by evidence, is not the appropriate vehicle for advancing these positions".

The Board's comments apply equally in this case.

5.3 Is the forecast of long term debt for 2010-2012 appropriate?

Hydro One has agreed to update for 2010 actual debt issues in the final rate order for 2011.

Consistent with the Board's directive in EB-2009-0096 Hydro One will reflect the actual 2011 debt issues when finalizing 2012 rates.

6. DEFERRAL/VARIANCE ACCOUNTS

6.1 Are the proposed amounts, disposition and continuance of Hydro One's existing Deferral and Variance accounts appropriate?

In addition to the IPSP account discussed below in Issue 6.2, the Applicant is seeking approval of the amounts and the proposed disposition of four other accounts: Export (Transmission)

Service Credit Revenue, External Secondary Land Use Revenue, External Station Maintenance and E & CS Revenue and Pension Cost Differential. The total amount for disposition, based upon audited actual 2009 balances, together with forecast carrying costs for 2010, is a net credit of $7.4M.

There was no challenge to the amounts recorded in the accounts (save for the IPSP account discussed below). Accordingly, Hydro One requests that the amounts be approved for disposition as requested.

In order to mitigate the rate impacts upon consumers in 2011, Hydro One proposed to refund the amounts owing to ratepayers in 2011 and proposed to recover amounts owing to the Company over the two test years. There appears to be some misunderstanding about the Company's proposal based on the intervenor arguments.

As the anticipated rate increase is larger in 2011, Hydro One remains of the view that its proposal is in the best interests of the consumers. Should the Board determine that a different disposition period is appropriate, Hydro One will of course follow the Board's direction.

Hydro One initially did not propose to continue the three accounts related to external revenues. However, as noted in Issue 2.2, Hydro One is agreeable that the Board approve continuation of these three external revenue accounts (Station Maintenance and Engineering & Construction revenues, Secondary Land Use revenues and Export {Transmission} Service Credit revenues).

In addition, Hydro One proposes to continue the Pension Cost Differential Account, the Long-term Project Development OM&A Account, the Tax Rate Changes Account and the IFRS Incremental Transition Costs Account. These accounts are all continuations of accounts previously approved by the Board. There was no opposition to continuing these accounts, and thus, Hydro One asks that their continuation be approved by the Board in this proceeding.

Finally, Hydro One requested continuation of the OEB Cost Differential Account. Board staff opposed continuation of this account, as did some intervenors.

Inadvertently Hydro One initially included an incorrect title and description in its request for continuation of the OEB Cost Differential Account. Hydro One is in fact requesting the continuation of the previously Board approved account entitled OEB Cost Assessment Differential Account (1508) with no changes in scope.[35]

Hydro One's request to continue to track the differential between forecast and actual annual OEB cost assessments in this account for 2011 and 2012 is consistent with the existing account that was approved by the Board in the last transmission rate proceeding, EB-2008-0272. A similar account was recently approved by the Board in EB-2009-0096 in Hydro One's last distribution rate proceeding.

Hydro One requests that the Board allow continuation of this account.

6.2 Is the proposed disposition of the "IPSP and Other Preliminary Planning Costs" deferral account for 2009 appropriate?

Hydro One is proposing to recover a balance in this account of $1.9M, together with accrued interest to December 31, 2010 for a total of $2M.

Hydro One notes that Board staff had no submission on the proposed balances for disposition, nor did most of the intervenors.

CCC was alone in its submission that Hydro One should be denied recovery of this account balance.

This account was created as a result of the Board's decision in the last transmission rate case EB-2008-0272 to record preliminary planning costs for IPSP and other long-term projects. In

[35] Exhibit I, Tab 1, Schedule 92.

addition to the work that was initiated to support the IPSP, some of the work was initiated through discussions with Ministry staff and in anticipation of the Minister's letter of September 21, 2009. Development work increased following the Minister's letter which instructed Hydro One to "immediately proceed with the planning, development and implementation of Transmission Projects outlined in the attached Schedule A." Based on the target in service dates for some of the projects, work had to ramp up very quickly if those targets were to be met.[36]

Hydro One's pre-filed evidence explained the amounts recorded in the account on a project by project basis.[37] Again, Hydro One was not asked any interrogatories by CCC about the costs recorded in the account, nor were its witnesses questioned about this during the oral phase of the proceeding. CCC did not advance any good reason to disallow recovery.

The Applicant therefore requests that the Board approve the recorded balance in the IPSP account and similarly approve its proposed disposition.

6.3 Are the proposed new Deferral and Variance Accounts appropriate?

Hydro One's application is premised on the assumption that modified MIFRS will apply commencing in the 2012 test year. As a result, Hydro One has requested Board approval to establish two new deferral accounts.

- IFRS – Gains and Losses Account
- IFRS – Impact for Changes Account

IFRS – Gains and Losses Account

[36] Exhibit A, Tab 11, Schedule 4.
[37] Exhibit F1, Tab 1, Schedule 1, page 6.

Hydro One proposed to establish this new deferral account to allow Hydro One to record gains and losses on asset sales and losses resulting from premature asset retirements in a deferral account, which would be subject to Board review prior to disposition.

Board staff agreed that Hydro One has justified the need for this account. VECC agreed that the account should be established. In doing so, VECC noted that the account should also include a depreciation credit that "would be calculated based on the amount of depreciation in approved revenue requirement that will not be incurred as a result of an asset premature retirement."

Hydro One agreed that the account should be credited for any depreciation expense in rates that will not be incurred as a result of premature assets retirements.[38] However, it is important to note that in cases of premature retirement, a depreciation credit would only be appropriate where the asset is not replaced by a like asset. In such cases, there is no reduction in depreciation expense. Rather, due to inflation, there is often an increase in depreciation expense that would not be recoverable until the next rebasing.

SEC argued against the establishment of this new account, noting that the Board has no estimate of the impact and that Hydro One is triggering this issue itself by "electing" to adopt IFRS for regulatory purposes in 2012.

Hydro One submits that it needs this account precisely because it is not able to derive an estimate that could be included in revenue requirement. In addition, based on historical results, it is clear that this account will have a debit balance reflecting net losses. Failure to establish the account would result in part of an asset's capital cost not being recovered from customers and incomplete capital recovery. This would be neither a just nor reasonable result.

It is also important to note that Hydro One is not opting or "electing" to adopt IFRS for regulatory purposes in 2012. Under EB-2008-0408, as reinforced by the Board's November 8,

[38] Exhibit I, Tab 4, Schedule 51.

2010 letter to distributors entitled "Transition to IFRS – Amendment to Board Policy," all distributors must adopt MIFRS in 2011 or 2012. As 2012 it the latest approved date for adopting IFRS, it is disingenuous to argue that Hydro One is somehow creating this issue for itself.

The Applicant asks the Board to approve the establishment of this account as proposed.

New Changes in IFRS Account

Hydro One also requested approval to establish an account to track the impact of changes in IFRS standards or their interpretation. The exact same account was approved by the Board in Hydro One's recent distribution rate case, EB-2009-0096. Board staff agreed that Hydro One had justified the need for this account.

Only SEC argued against the proposal, claiming that it is an account that is an "unacceptable exception to the forward test year concept." SEC also argued that this account was considered and rejected in EB-2008-0408 and that the risk should be Hydro One's as a result of choosing to file a two year cost of service application. The former assertion is incorrect and the latter irrelevant in the Applicant's submission.

As noted above, this same account was approved in Hydro One's last distribution case, in which intervenors also argued that this type of account had been discussed and rejected in EB-2008-0408. Hydro One demonstrated that this was not the case and the requested account was approved. Further, similar to this application, the last distribution proceeding was a two-year cost of service application with the first year being based on CGAAP and the second based on MIFRS.

Hydro One also notes that future changes in IFRS cannot be equated with generic forecast risk. As IFRS is being used as the underlying framework for the Board's MIFRS regulatory accounting and reporting, it is reasonable to record the 2012 revenue requirement impacts resulting from changes in IFRS in a variance account for future review, whether they are increases or decreases. SEC's proposal to require in year refiling, which is comparable to triggering an IRM off-ramp, every time there is a significant change in IFRS accounting standards, would put an onerous burden on the Board, affected utilities and intervenors.

Hydro One asks that the Board reject the argument of SEC and approve establishment of this account exactly as was done for the utility's distribution business.

7. COST ALLOCATION

7.1 Is the cost allocation proposed by Hydro One appropriate?

Hydro One submits that its proposed cost allocation is appropriate and in accordance with methodology previously approved by the Board in EB-2008-0272. Hydro One acknowledged an error in the assignment of some assets to the "Other" functional category and indicated that it would reflect the proper assignment in the final rate order following the Board's decision.[39]

Subject to the adjustment referred to above, Hydro One submits that the proposed cost allocation is appropriate and asks that the Board so find.

8. CHARGE DETERMINANTS

8.1 Is it appropriate to implement "AMPCO's High 5 Proposal" in place of the status quo charge determinants for Network service?

Contrary to Board staff's submission, Hydro One does believe that the Board has enough information and evidence before it to resolve the Network rate design issue as part of this application. Board staff argued that the Board should direct Hydro One to develop further alternatives to the Network charge determinant and bring those forward in its next transmission rates application.

[39] Exhibit I, Tab 4, Schedule 60.

Hydro One disagrees.

As Mr. Andre testified, a number of Network charge alternatives were considered in EB-2006-0501, one of Hydro One's prior transmission rate applications. Those alternatives resulted from an extensive stakeholdering effort and included several alternatives one of which based the charge on the customer's 12 coincident peaks (i.e. removing of the 85% "ratchet").

Additional studies come at a cost both in time and money. At a time when the Company is being urged to keep its costs to a minimum with large expansions in its planned work programs, Hydro One believes that it would be inappropriate to require the Company to again assess this issue at this time.

AMPCO's High 5 Proposal

Hydro One as a transmitter is financially neutral on this issue which is essentially a matter of fairness between its various customer groups. However, it does have a responsibility to promote fairness among customers. Hydro One observes that only CME supported AMPCO's proposal, while most others asked the Board to reject it.

Hydro One offers the following comments to assist the Board in making a fully informed decision when assessing AMPCO's proposal.

The Board indicated in its decision in EB-2008-0272, Hydro One's last transmission proceeding, that it believed the AMCPO proposal had overall merit based on the understanding that "system peak is a significant costs driver in the electricity commodity market and also is of relevance for transmission system planning".

Hydro One commissioned a study from Power Advisory (PA) to objectively assess AMPCO's proposal. The PA study filed in this proceeding showed that adoption of the High 5 proposal will result in net commodity cost reductions which are significantly smaller than those estimated by AMPCO and will not result in any material deferral of future transmission investments [40].

Hydro One shares the concerns expressed by Board staff and other intervenors related to fairness. In its argument, Board staff stated: “The objective of fairness includes consideration of who caused the costs already incurred for existing facilities, along with consideration of who benefits from the existing system.” Hydro One agrees with this statement.

On balance, Hydro One continues to believe that the existing compromise reflects a fair balancing of cost responsibility among its customers.

In the event that the Board accepts AMPCO’s proposal, Hydro One disagrees that July 1, 2012 is an appropriate implementation date as suggested by AMPCO. The date proposed for implementation is inconsistent with the current January 1 implementation date for transmission rates and would cause further rate changes during the year.

If the Board adopts the High 5 Proposal, Hydro One submits that the appropriate implementation is January 1, 2012.

Both Board staff and CME suggest the possibility of a phased implementation of the High 5 proposal, if adopted. Hydro One has serious concerns with how a phased implementation would work. CME’s argument refers to a phased approach used in an Enbridge Gas Distribution (EGD) case. Hydro One states that that is not applicable to the High 5 situation, as the EGD decision related primarily to a change in the cost allocation methodology which resulted in different rates that were then phased-in over time. Unlike new rates which can be “harmonized” or phased-in over a number of years, adoption of High 5 means a complete change in the methodology. It is unclear and uncertain how adoption of a radically different charge determinant methodology could be done over a number of years.

[40] Exhibit H1, Tab 3, Schedule 1, Attachment 1, page 77.

Hydro One of course will reflect the Board's decision on this issue in the appropriate rate orders.

9. GREEN ENERGY PLAN

9.1 Are the OM&A and capital amounts in the Green Energy Plan appropriate and based on appropriate planning criteria?

There was a good deal of discussion and time devoted during the oral hearing about the Applicant's Green Energy Plan. The Company's witnesses quite readily acknowledged that a good deal had changed since the Green Energy Plan was originally filed. The Green Energy Plan was premised, in large part, on the letter that Hydro One received from the Minister dated September 21, 2009. That letter identified a number of projects that the Company was asked to undertake and to begin work on immediately. Hydro One did so.[41]

Subsequently, Hydro One was asked to hold off on further work in light of a request that the Minister made to the OPA. As a result, there is uncertainty about the specific projects that were initially part of the Green Energy Plan.

Understandably, there was concern expressed in the hearing about what Hydro One is asking the Board in relation to its Green Energy Plan as filed. Hydro One's position was explained in Undertaking J3.10 and further by its counsel.[42]

Hydro One is seeking approval for the specific following Green Energy Projects which are expected to come into service in the test years outlined in the table[43] below:

[41] The Minister identified projects as Schedule A, which are generally large transmission projects which require a Section 92 application or Schedule B which are generally to facilitate the connection of distributed generation and do not require a Section 92 application.
[42] Transcript Volume 6, pages 1-6.
[43] The amounts referred to in the table refer to total project costs.

GREEN ENERGY PROJECT IN-SERVICE ADDITIONS
($ MILLIONS)

		2011	2012
D11	Toronto Area Station Upgrades for Short Circuit Capability: Rebuild Hearn SS		**84.9**
D12	Toronto Area Station Upgrades for Short Circuit Capability: Leaside TS Equipment Uprate		**37.4**
D37	In-Line Circuit Breakers #1		**20.3**
D38	In-Line Circuit Breakers #2		**20.3**
D43	Station Protection Upgrades for Distributed Generation	**5.3**	**15.8**
D44	Transfer Trip Facilities	**4.7**	**14.0**
Green Energy Projects Less than $3 M		**1.4**	**6.2**
Total Green Energy Project Capital		**11.4**	**198.9**

There seems to be near consensus that these projects should be approved and Hydro One asks that they be approved.

In the table below is a summary of all of the Green Energy related projects in which the Company forecasts spending to occur in the test years, including the six projects referred to in the table above.

GREEN ENERGY PROJECT
ANNUAL CAPITAL EXPENDITURES
($ MILLIONS)

		2011	2012
D11	Toronto Area Station Upgrades for Short Circuit Capability: Rebuild Hearn SS	**54.6**	**27.0**
D12	Toronto Area Station Upgrades for Short Circuit Capability: Leaside TS Equipment Uprate	**13.5**	**21.9**
D13	Toronto Area Station Upgrades for Short Circuit Capability: Manby TS Equipment Uprate	**9.0**	**9.2**
D32	Enabling 230/44kV TS #1 and Short (<2km) Tap	**0.05**	**8.4**
D33	Enabling 115/44kV TS #1 and Short (<2km) Tap	**0.05**	**8.4**
D34	Algoma x Sudbury Transmission Expansion	**0**	**5.7**
D35	Northwest Transmission Reinforcement	**4.5**	**16.9**
D36	Static Var Compensator #1 at Existing Station in South Western Ontario	**0.4**	**32.9**
D37	In-Line Circuit Breakers #1	**13.4**	**6.9**
D38	In-Line Circuit Breakers #2	**13.4**	**6.9**
D39	In-Line Circuit Breakers #3	**3.2**	**7.2**
D40	In-Line Circuit Breakers #4	**3.2**	**7.2**
D41	In-Line Circuit Breakers #5	**0**	**1.2**
D42	In-Line Circuit Breakers #6	**0**	**1.2**
D43	Station Protection Upgrades for Distributed Generation	**5.3**	**15.8**
D44	Transfer Trip Facilities	**4.7**	**14.0**
	Green Energy Projects	125.3	**190.8**
Green Energy Projects Less than $3 M		**1.4**	**7.3**
Total Green Energy Project Capital		**126.7**	**198.1**

While there is currently uncertainty in the priority of projects in the Green Energy Plan, Hydro One submits that the forecast level of capital spending remains appropriate. Mr. Young explained that once the ECT process is completed, there is still expected to be significant spending on Green Energy projects in 2011 and 2012.[44] Hydro One still expects that a number of projects will be required to connect the vast amounts of renewable generation that has come forward in response to the FIT program.[45]

Hydro One submits that Board approval of the overall Development Capital spending does not mean the individual projects have been Board approved, but rather an acknowledgment by the Board that the overall forecast spending is reasonable. These projects will come before the Board again in either a Section 92 application or subsequent rate case when they are forecast to go into rate base. Hydro One will seek Board approval for specific projects at that time and will provide economic evaluations of those projects in those subsequent proceedings for consideration by the Board.

Thus, Hydro One submits that the overall forecast of capital spending is reasonable even though specific projects may change.

In summary, Hydro One asks the Board to approve the Green Energy Plan as filed. The vast majority of the spending is beyond the test years and approval of the Plan in no way binds the Board on the approval of specific projects or of future expenditures beyond the test years. As Hydro One explained through its counsel, the plan at this time is "conceptual" since circumstances have changed since the Applicant filed its Green Energy Plan in this case. However, Hydro One submits that the plan is conceptually appropriate in light of the objectives of the Green Energy Act and the previous direction received from the Minister by his letter of September 21, 2009.

If the Board is not prepared to approve the Plan as requested, then Hydro One requests approval of its overall Development Capital budget as detailed in Exhibit D1, Tab 3, Schedule 3. Hydro One anticipates further direction from the OPA and the Minister. Once received, Hydro One requires the flexibility to proceed with new projects as directed. As noted above,

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[44] Transcript Volume 3, page 177.
[45] Transcript Volume 3, page 115.

this is not project specific approval, but rather approval of the overall Development Capital Budget.

Leaside and Manby Station Upgrades: Cost Responsibility

Hydro One proposes that the costs of these projects be borne fully by its transmission customers. Hydro One has received support for its proposal from Pollution Probe, Toronto Hydro, BOMA & LPMA and the OPA. Board staff argue that a portion of the costs should be borne by Toronto Hydro.

Hydro One disagrees that any advancement costs for these projects should be borne by Toronto Hydro for the reasons outlined below.

These projects have evolved over a period of many years and are part of the overall transmission planning in the Toronto area. While they will allow the connection of additional generation these projects have not been initiated to respond to specific requests for connection from generators. These projects are being done proactively with the knowledge that accommodating the connection of generators will be required in the next few years.

The majority of the assets being replaced are at end of life. The advancement of some assets that are near end of life is being done to gain the efficiencies of doing all the work at one time and as one project. BOMA & LPMA agree with Hydro One and stated in their argument that "given the relatively short remaining useful life of these assets, it makes no sense to defer refurbishment until the useful life of the facilities is completely exhausted."

Hydro One's rationale for pooling the advancement costs in transmission rates rather than collecting a capital contribution from Toronto Hydro for the advancement portion of the work is that the costs are system driven. Typically, system driven costs are pooled while costs that are customer driven are allocated to the customer. The OPA, Toronto Hydro and Pollution Probe support this proposition. In addition, Mr. Young during the oral proceeding, explained the benefits of these projects to transmission system operation as well as to generators outside the Toronto area.[46]

The Board has recognized the ability of distributors to pass on transmission costs to distribution customers in at least three instances: i) Section 11.7 of the Board's *Electricity Distribution Rate Handbook* permits a distributor to recover third party costs as a flow-through charge to the customer; ii) the Board's Decision and Order in Hydro One's Connection Procedures proceeding (EB-2006-0189) Section 3.5.2 states that a distributor may collect from a customer third party costs relating to transmitter classed assets subject to justification at the time of the distributor's rebasing application; and iii) the Board's *Revised Proposed Amendments to the Distribution System Code* (EB-2009-0077) dated September 11, 2009, states that the costs of any upgrades to the system of a transmitter or host distributor would be the responsibility of the connecting generator.

If the advancement of the projects had been initiated as a result of generators requesting connections to these stations, Toronto Hydro could have entered into connection cost recovery agreements (CCRA) that passed the costs on to the generators.

Mr. Young explained that any delay in these projects that moves them closer to the 2015 Pan Am Games could result in significant project delays due to problems in obtaining outages, with the effect of compromising the security or stability of the system at a critical time.[47] Mr. Young also noted that operating at higher short circuit levels in order to connect additional generators cannot be achieved until all the equipment that needs to be upgraded has been completed.[48]

Thus, while these upgrades will facilitate the connection of generators, the assets are near end of life or at end of life and require refurbishment. These projects are part of the larger Toronto

[46] Transcript Volume 2, pages 147-8.
[47] Transcript Volume 3, pages 185-6; see also Exhibit I, Tab 1, Schedule 113.
[48] Transcript Volume 3, page 183.

area transmission planning. Hydro One thus submits that it is appropriate that all of the associated costs be borne by their transmission customers.

Hydro One agrees with OPA's submission that the Board should consider initiating a generic proceeding to address these cost responsibility issues. Hydro One would fully participate in this proceeding.

P&C Investments for Enablement of Distribution Connected Distributed Generation – Projects D43 and D44

Hydro One proposes that these costs also be borne by its transmission customers. Hydro One does not agree with Board staff's submission that the cost of these investments should be recovered from the LDCs connected to transmission stations where the work is done; and that the LDCs should then collect the costs from connecting generators.

Many of these investments will be at network stations and will be part of the network facilities. Even when these investments are being made at connection stations, they have benefits to the larger network system and should be recovered as part of the transmission charges.[49] It is not possible to identify exactly how many network or connection stations will be impacted at this time. Typically, system driven costs are pooled while costs that are customer driven are allocated to the customer.

In customer driven cases, Hydro One follows the TSC for connection work and charges capital contributions accordingly. As Mr. Young explained Hydro One will collect capital contributions from connecting generators for enabling transmission stations. The need for these stations will be triggered by generators applying to connect to the transmission system and they will be allocated the costs accordingly.

[49] Exhibit I, Tab 1, Schedule 118.

The P&C investments are not in response to additions of generating capacity in the same way. These investments are not like capacity additions. These investments are triggered by the presence of enough generation on the system to require changes to the overall protection settings and facilities.[50]

While one generator might trigger the need for these investments at a particular station, the need is to accommodate existing and future generators and the benefit is for all of them as well as the load customers also served by that station or served by other stations on the same supply or network circuit. It would not be possible at the point in time the need is triggered to identify all of these generators as their presence could occur over a period of many years before and after that trigger point is reached.

For example, in the case of project D44, the wide area transfer trip is required when there are disturbances and outages on the transmission facilities upstream of the transformer connection stations. Such facilities are required by the transmitter to safely and efficiently restore equipment and conduct maintenance. These facilities can only be installed efficiently, from both cost and P&C personnel resource perspectives if the stations associated with the upstream transmission facilities are performed at the same time. These facilities would likely prove cost prohibitive for the first or even first few small generators to fund.

The investments in project D43 include some modifications of P&C facilities which are required for system purposes. For example, changes to under frequency load shedding (UFLS) relays and special protection schemes (SPS), such as load rejection schemes. These may involve facilities at the transformer connection stations but are required to reflect changing conditions of <u>net</u> load not specifically to connect distributed generation. UFLS and SPS facilities are required to ensure stability and acceptable voltage performance for the system. These types of system protection facilities are not funded specifically by connection customers where these facilities reside. Also the timing of these modifications may not occur until a sufficient level of distribution generation has already connected which would then require

[50] See Exhibit D2, Tab 2, Schedule 3 and Exhibit I, Tab 1, Schedule 118.

seeking contributions after the fact since it would be unfair for the triggering generator to fund all the costs.

If the distributors were charged for these investments there would be a very difficult and administratively costly process required. Hydro One would have to negotiate CCRAs with the LDCs at each of the transformer stations involved in undertaking this work. The LDCs would then in turn have to negotiate CCRAs with the numerous generators that connect to their systems.

Mr. Young explained the complexity of negotiating CCRAs and arranging security deposits in a case that only involved four generators connected at the transmission level. The case described by Mr. Young was feasible because all four projects were seeking connection at the same time; they were large enough to have the necessary access to credit; and they had the legal and technical capacity to enter into complex arrangements involving multiple parties. Such opportunities are expected to be rare where many and much smaller generators are involved.[51]

In summary, Hydro One's submission is that treating the cost of these investments as transmission costs is not only technically more correct in linking system costs to system benefits but also eliminates the very high administrative burden and cost that would be involved in charging distributors who in turn would have to charge generators for these costs. For small generators at the distribution connection level, such a heavy and complex administrative burden could introduce significant delays to connection and would represent a barrier to entry for them.

Hydro One submits that the Board should approve its approach and find that the costs for these projects ought to be funded by all of its transmission customers.

[51] Transcript Volume 3, pages 190-2.

Should the Board order a cost recovery approach, Hydro One and possibly many LDCs, will have to find a manageable mechanism for allocating and recovering the costs. This could entail "postage stamp" rates or potentially different rates at each TS depending on the nature of the modifications, and if necessary, may require approvals from the Board.

9.2 Are Hydro One's accelerated cost recovery proposals for the Bruce-to-Milton line and for Green Energy projects appropriate?

Hydro One has applied to this Board for accelerated cost recovery for the Bruce to Milton Transmission project in accordance with the January 15, 2010 Report of the Board: The Regulatory Treatment of Infrastructure Investment in Connection with the Rate-regulated Activities of Distributors and Transmitters in Ontario ("the Board Report").

The Board Report outlines a number of criteria which must be satisfied in order for the Board to consider whether an alternative mechanism for cost recovery is appropriate. In its argument, Board staff acknowledged that most of the criteria have been satisfied. Board staff, along with other intervenors have opposed the Applicant's proposal, arguing that two criteria have not been satisfied: whether the project has risks or particular challenges and the public interest benefits in granting the alternative mechanism. It is these two criteria which were canvassed during the oral portion of this proceeding.

Hydro One will briefly address both of these issues, but first will summarize its position. Hydro One believes that the criteria outlined in the Board Report have been met in this case. The most compelling factor to the Applicant is the benefit that the proposed alternative mechanism will have for ratepayers.

As Mr. Struthers testified, if the Board is not satisfied that alternative treatment is appropriate in the circumstances of this particular case, then the Applicant is prepared to accept the standard AFUDC treatment with a 2012 in service date.

The Risks of the Bruce-Milton Project

There are a number of risks associated with this particular transmission project. As Mr. Gregg testified, one of the most significant risks is related to ongoing consultations with First Nations. One of the bands that the Hydro One is consulting with on the Bruce to Milton project is the same band which was involved in direct action that stopped construction of the Niagara Reinforcement Project which today remains at a standstill.

In addition, a number of other risks outlined in the Board Report including project delays, landowner issues, project completion, third party intervention, regulatory challenges and land acquisition challenges are relevant to the Bruce to Milton project. Many of these were acknowledged by Board staff. In fact, a number of these risks have already materialized resulting in at least a one year delay in the project.

In light of the above, the Applicant submits that the evidence establishes that there are numerous risks and challenges associated with the Bruce to Milton project, and accordingly, an alternative cost recovery mechanism is appropriate. Hydro One notes that Board staff observed that this project does not present “unique” risks to the Company. The Board Report does not require a project to have “unique” risks, but rather risks in general associated with project completion. The Board must consider this one criterion in light of all of the other factors present.

The Public Interest Benefits in Granting the Alternative Mechanism

Hydro One’s analysis, as detailed in the prefiled evidence and as explained by Mr. Struthers is that the overall cost of the project is $9.7M less using the alternative mechanism when a net present value of the project is considered. Using the standard cost treatment approach of allowing AFUDC treatment, the overall cost of the project is $848.7M, whereas the cost is $839.0M using the proposed alternative mechanism.

Many intervenors, including BOMA & LPMA and SEC challenged Hydro One's analysis. The primary criticism is the assumed discount rate used by the Applicant when calculating the net present value of the project. Hydro One used the after tax discount rate based on Hydro One's cost of capital, a methodology that has been accepted by the Board. This is the standard methodology used for economic evaluations in Section 92 applications when assessing overall project economics and rate impacts.

Intervenors argued, without evidentiary foundation, that a proxy for the consumer's cost of capital should be used. Hydro One's view is that if a proxy is to be used, then the OPA's social discount rate is the best proxy.

As Board staff noted, the real task for the Board to consider is whether the benefit to ratepayers of an overall lower cost of the project and the rate smoothing effect achieved by not having the entirety of this large project come into rate base at once outweighs the short term increased bill impact in the test years. Hydro One agrees with this proposition.

All of which is respectfully submitted.

D. H. Rogers

Anita M. Varjacic

Counsel to the Applicant Hydro One Networks Inc.

APPENDIX A

Hydro One Networks Inc.
EB-2010-0002 Transmission Approvals Requested (Revised)

Hydro One Networks ("Hydro One" or "Hydro One Transmission") is applying for an Order approving the revenue requirement, cost allocation and rates for Hydro One's Transmission Business for years 2011 and 2012 ("test years") under the assigned Docket Number EB-2010-0002. This summary provides a brief description of the approvals being sought through this Application.

Revenue Requirement

1. A revenue requirement of $1,433M and $1,533M for the 2011 and 2012 test years, respectively. These amounts are updated from those as set out in Exhibit E2, Tab 1, Schedule 1 to reflect the impact of HST[1], several corrections to the calculation of PILs and the impact of 2010 actual bond issues on the long-term debt rates in the test years. As a result of these adjustments Hydro One Transmission's Rates Revenue Requirement is now 14.7% and 9.7% in 2011 and 2012, respectively, versus the 15.7% and 9.8% originally requested. This now represents an estimated increase on total customer bills of 1.1% in 2011 and 0.7% in 2012.

2. Approval of the Company's Transmission Green Energy Plan filed as part of this Application in accordance with Section 70, (2.1), 2 of the *OEB Act, 1998*. This plan is provided in Exhibit A, Tab 11, Schedule 4. Specific approvals were highlighted by Mr. Rogers at transcript Volume 6, pages 1 – 6.

3 Total capital expenditures of $1,152M in 2011 and $1,008M in 2012. Details of Hydro One Transmission's capital expenditures are provided in schedules filed at Exhibit D2, Tab 2 and discussed in detail in schedules within Exhibit D1, Tab 3.

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[1] Please note that the HST impact will change the proposed levels of OM&A, capital expenditures, rate base, depreciation, return on capital and income tax. Any changes to the proposed levels of OM&A and Capital expenditures in the Board Decision in this proceeding will alter the estimated levels of the HST impact. As a consequence, the HST impact will be re-estimated as necessary and will be fully detailed in the Draft Final Rate Order.

4. An OM&A cost expenditure forecast of $436M in 2011 and $450M in 2012. These expenditures are itemized in Exhibit C2, Tab 2, Schedule 1 and discussed in written direct evidence in the schedules within Exhibit C1, Tab 2.

5. The existing Export Transmission Service (ETS) rate of $1/MWh to be continued and disbursed through a decrease to the revenue requirement for the Network Pool. The forecast for ETS revenue is $10.1M for 2011 and $10.2M for 2012, based on the IESO's 2010-2012 Business Plan which was filed as part of their 2010 Rate Submission in Proceeding EB-2009-0377. The ETS rate is discussed in Exhibit H1, Tab 5, Schedule 1.

6. The recovery of Low Voltage Switch Gear compensation amounts of $11.6M and $12.4M which have been updated from those as discussed in Exhibit G1, Tab 6, Schedule 1 in order to reflect the changes summarized in Item 1 above.

7. The audited 2009 year end regulatory assets balance totaling ($7.4)M as at December 31, 2010. Hydro One Networks seeks approval to refund over a one year period regulatory assets with a net balance of $(12.4)M, to reduce the annual revenue requirement for rate mitigation purposes and to recover over a two year period regulatory assets with a balance of $5.0M. The Company's submissions regarding these account balances and their proposed disposition appear at Exhibit F1, Tab 1, Schedule 1; Exhibit F1, Tab 2, Schedule 1 and Exhibit F2, Tab 1, Schedule 2.

8. The deemed capital structure of 60% debt and 40% common equity, as approved by the Board in its EB-2008-0272 Decision, for Hydro One Transmission in determining its 2011 and 2012 revenue requirement. Hydro One is currently requesting an equity return of 10.16 % for the 2011 test year and 10.41 % for 2012, using the latest Board formulaic methodology from the EB-2009-0084 proceeding, issued on December 11, 2009 using the September 2009 Consensus Forecast. The

Company expects that the return on equity ("ROE") and short term debt parameters for 2011 and 2012 will be updated to reflect the September 2010 and September 2011 Consensus Forecasts and Bank of Canada data available in October or November of 2010 and 2011 as described at Exhibit B1, Tab 1, Schedule 1. The cost of long term debt has been updated with all bond issues made in 2010. In the fall of 2011 the cost of long term debt for 2012 will be updated with the 2011 actual bond issues.

9. Hydro One Transmission's Rate Base of $8,379M for 2011 and $9,135M for 2012 as discussed in Exhibit D1, Tab 1, Schedule 1.

10. Accelerated recovery of construction work in progress ("CWIP") for the Bruce to Milton project as described at Exhibit A, Tab 11, Schedule 5 and further elaborated on at Exhibit I, Tab 1, Schedule 122. Note that the annual accelerated CWIP recovery totals would be modified as per the updated Cost of Capital parameters for 2011 and 2012 as outlined in Item 8 above. The accelerated recovery of CWIP amounts are $43.6M in 2011 and $26.0M in 2012 (with a total 2012 Revenue Requirement impact of $55.5M which includes the portion of Bruce to Milton costs to be recovered via the standard addition to rate base treatment in the year when the project is placed in service) as summarized in Exhibit I, Tab 1, Schedule 122, Attachment 1. If the Board denies Hydro One's request for accelerated recovery of CWIP, the Company would request the Board to approve the total project costs of $762.9M following the standard AFUDC approach as noted by Mr. Gregg at transcript reference Volume 3, pages 39 and 40.

11. The submission is based on Canadian Generally Accepted Accounting Principles ("CGAAP") for 2011. For 2012 the submission is based on International Financial Reporting Standards ("IFRS") as modified by the Board in its EB-2008-0408 report "Transition to International Financial Reporting Standards" in concert with two specific exceptions being requested by Hydro One for rate mitigation purposes and to ensure capital recovery respectively. For 2012, the assumption is made that

CGAAP revenue requirement is generally equivalent to that calculated under IFRS. The first requested exception is to allow the Company to continue to capitalize certain expenditures that are not capitalized under IAS 16 “Property, Plant and Equipment”. The estimated effect of this exception is a reduction in the annual revenue requirement of $200M in 2012 and beyond as Mr. Fraser testified: transcript reference Volume 7, page 38 and 39. Hydro One is also requesting a second exception which would allow for gains and losses on the premature retirement or disposition of assets to be recorded in the requested IFRS – Gains and Losses Deferral Account for future disposition or recovery from customers. Exhibit A, Tab 11, Schedule 3 provides further details respecting these requests.

Cost Allocation and Rates

The Company also seeks approval of:

12. The continuation of Hydro One Transmission’s cost allocation methodology, as described in Exhibit G1, Tab 2, Schedule 1 and supported by the remainder of the G Exhibit.

13. The continuation of a wholesale metering services pool, as discussed in Exhibit G1, Tab 5, Schedule 1.

14. The revenue to be collected by each Rate Pool as discussed in Exhibit G1, Tab 1, Schedule 1.

15. The charge determinant application to each Rate Pool as discussed in Exhibit H1, Tab 3, Schedule 1.

16. Charges for the provision of wholesale metering services and export transmission services performed by the utility as set out at Exhibit H1, Tab 4, Schedule 1 and Exhibit H1, Tab 5, Schedule 1, respectively.

17. The disposition of the balances accumulated in Regulatory Accounts as shown in Exhibit F1, Tab 2, Schedule 1.

18. Hydro One Networks also requests that the Board amend the Uniform Transmission Rates to allow for recovery of the proposed revenue requirements for 2011 and 2012, effective January 1st of each year.

Other

19. Hydro One Networks seeks approval to continue the following deferral accounts including, the IFRS Incremental Transition Costs account, the Pension Cost Differential account, the Tax Rate Changes account, the OEB Cost Assessment account and the Long-term Project Development OM&A Account, as well as the following external revenue variance accounts, Export (Transmission) Service Credit Revenue, Secondary Land Use Revenue and Station Maintenance and E&CS Revenue. The Company also requests the establishment of two new variance accounts for the 2012 test year, the Impact for Changes in IFRS Account and the IFRS – Gains and Losses Account. These are discussed in Exhibit F1, Tab 1, Schedule 2.