

**Ontario Energy  
Board**

**Commission de l'énergie  
de l'Ontario**



**EB-2010-0002**

**IN THE MATTER OF AN APPLICATION BY**

**HYDRO ONE NETWORKS INC.**

**2011 and 2012 TRANSMISSION REVENUE REQUIREMENT  
AND RATES**

**DECISION WITH REASONS**

December 23, 2010

## TABLE OF CONTENTS

<b>BACKGROUND</b> .....	1
<b>LOAD FORECAST</b> .....	4
<b>OPERATIONS, MAINTENANCE AND ADMINISTRATION EXPENSE</b> .....	8
Overall OM&A.....	8
Sustaining.....	11
Development .....	13
Operations.....	15
Shared Services and Other .....	15
Compensation .....	16
Taxes other than income taxes.....	21
<b>RATE BASE AND CAPITAL EXPENDITURES</b> .....	24
<b>GREEN ENERGY PLAN</b> .....	32
<b>EARLY INCLUSION OF CWIP IN RATE BASE FOR THE BRUCE TO MILTON PROJECT</b> .....	44
<b>CAPITAL STRUCTURE AND COST OF CAPITAL</b> .....	48
<b>FORECAST OF OTHER REVENUES</b> .....	51
<b>FORECAST OF EXPORT REVENUES</b> .....	53
<b>DEFERRAL AND VARIANCE ACCOUNTS</b> .....	55
<b>NETWORK CHARGE DETERMINANT “HIGH 5”</b> .....	66
<b>EXPORT TRANSMISSION SERVICE (ETS) TARIFF</b> .....	71
<b>TOTAL BILL IMPACTS</b> .....	76
<b>IMPLEMENTATION MATTERS AND COST AWARDS</b> .....	83
APPENDIX A.....	1
APPENDIX B.....	1
APPENDIX C .....	1
APPENDIX D .....	1

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

**AND IN THE MATTER OF** an application by Hydro One  
Networks Inc. for an order or orders approving a  
transmission revenue requirement and rates and other  
charges for the transmission of electricity for 2011 and 2012.

**BEFORE:** Paul Sommerville  
Presiding Member

Ken Quesnelle  
Member

Paula Conboy  
Member

## **DECISION WITH REASONS**

**DECEMBER 23, 2010**

## **BACKGROUND**

On May 19, 2010 Hydro One Networks Inc. (Hydro One, the Applicant, or the Company) filed an application for 2011 and 2012 transmission revenue requirement and rates. The revenue requirement and charge determinants approved for Hydro One in this proceeding would be combined with other licensed Ontario transmitters to determine the Uniform Transmission Rates (UTRs) for 2011 and 2012. The Board assigned file number EB-2010-0002 to the application and issued an approved issues list on July 20, 2010.

Hydro One Networks Inc. is the largest electricity transmitter in Ontario with approximately 29,000 circuit kilometers of transmission line, 247 transformer stations and 33 switching stations. The network connects 91 generating stations, 51 Local Distribution Companies (LDC's) and 65 end-use transmission customers (89 connection points).

Hydro One sought approval of a transmission revenue requirement of \$1,446 million for 2011 and \$1,547 million for 2012, and approval of changes to the provincial UTRs that are charged for electricity transmission, to be effective January 1, 2011 and January 1, 2012.

The Board issued Procedural Order No.1 on June 28, 2010, establishing the procedural schedule for a number of early events and included a draft issues list.

The timing of the filing of the application was influenced by the receipt by the Company of a letter from the Minister of Energy, the sole shareholder of the Company on May 5, 2010. The Company's original proposal was held back in order to allow the Company to accommodate the Minister's instructions to re-focus the Company's proposals in the application to only those spending proposals necessary to ensure the safe and reliable operation of the system, and the implementation of capital programs specifically identified by the Ontario Power Authority as required immediately. The Company reviewed its application in light of the Minister's instruction and made consequential changes. The extent and adequacy of those changes was a matter of dispute among the parties in this case.

### **Intervenors**

The following intervenors took an active role in this proceeding: Vulnerable Energy Consumers Coalition (VECC), Building Owners and Managers Association of the Greater Toronto Area and the London Property Management Association (BOMA/LPMA), School Energy Coalition (SEC), Canadian Manufacturers and Exporters (CME), Consumers Council of Canada (CCC), Energy Probe Research Foundation (Energy Probe), Association of Major Power Consumers in Ontario (AMPCO), Power Workers Union (PWU), Ontario Power Authority (OPA), Independent Electricity System

Operator (IESO), Association of Power Producers of Ontario (APPrO), Bruce Power, HQ Energy Marketing Inc., Pollution Probe and Toronto Hydro-Electric System Limited (THESL). A full list of all 27 intervenors in this case is attached in Appendix "A".

### **Hydro One Motion**

Hydro One brought a motion before the Board on June 16, 2010 requesting an order severing the issue of the AMPCO proposal to alter the method of determining the transmission network charge, termed the "High 5 Proposal" (Issue 8.1), for review and assessment in a separate generic proceeding. The Board heard this motion on July 20, 2010 and denied the motion in an oral decision delivered on that day. The Board also issued its decision on the draft issues list in the same oral decision. That approved issues list was attached to Procedural Order No. 2, issued on July 21, 2010.

A copy of the decision on the motion is attached as Appendix B and the approved Issues List is attached as Appendix C.

### **Canadian Manufacturers and Exporters Motion**

CME brought a motion before the Board on the first day of the oral hearing, September 20, 2010, requesting an order requiring Hydro One to produce certain materials provided to the Hydro One Board of Directors and requested in CME Interrogatories 1 and 2. The Board granted the motion in an oral decision on September 20, 2010.

A copy of the decision on the CME motion is attached as Appendix D.

### **Intervenor Evidence**

Two intervenors filed evidence before the Board: AMPCO provided evidence on the High 5 charge determinant issue (Exhibit M-1), and CME provided evidence on Total Ontario Electricity Bill Impacts (Exhibit N-1).

### **Settlement Conference**

A settlement conference for this proceeding was held on September 16, 2010, however no settlement was achieved.

### **The Hearing, Submissions and Evidence**

The oral hearing for this proceeding took place in September and October 2010, concluding with Hydro One's oral argument-in-chief on October 7, 2010.

Board staff and intervenor submissions were filed on October 22, 2010 and November 2, 2010 respectively. The IESO filed its submissions on October 15, 2010. Hydro One submitted its reply argument on November 12, 2010.

Copies of the evidence, exhibits, submissions and transcripts of the proceeding are available for review at the Board's offices or on the Board website, [www.oeb.gov.on.ca](http://www.oeb.gov.on.ca).

Further procedural details are found in Appendix A.

### **Confidentiality**

During the proceeding, confidential treatment was requested for a number of documents. These documents are filed at the Board's offices.

The Board considered the full record of the proceeding but has summarized the record only to the extent necessary to provide context to its findings.

## LOAD FORECAST

Hydro One's transmission load forecast for the 2011 and 2012 test years, including the impact of Conservation and Demand Management (CDM), is shown in the table below:

**Transmission Load Forecast, 2011 and 2012  
(12 Month Average Peak MW)**

	Demand	Rate Categories		
		Network Connection	Line Connection	Transformation Connection
<b>2011</b>	20,613	20,150	19,500	16,850
<b>2012</b>	20,292	19,485	19,286	16,667

Source: Exhibit A/Tab12/Schedule 3

CDM, increased embedded generation and slower economic growth coming out of the recent economic downturn are the major influences on the 2011 forecast resulting in a 1.3 percent decrease 2010. For 2012, load is forecast to decrease by a further 1.6 percent.

The load forecast as presented in the pre-filed evidence was largely accepted without comment by Board staff and intervenors. Concern was raised by SEC and BOMA/LPMA respecting the apparently outdated information that was used in overall business planning and to develop the load forecast. For example, some of the forecasts date from November and December 2008.

The major load forecast issue raised in argument was the issue of the adjustment of the load forecast for CDM. This was primarily raised by VECC, supported by CCC.

VECC indicated that the Board, in its EB-2008-0272 decision, had found that it was appropriate for Hydro One to base its CDM adjustment on OPA information and analysis. In conformity with this direction Hydro One had used OPA information, but only information based on the OPA's CDM forecasts made as part of the Integrated Power System Plan (IPSP) proceeding (EB-2007-0707), which was suspended in 2008 as the result of a ministerial directive. VECC indicated that Hydro One had not used information recently released by the OPA as part of the CDM Targets consultation (EB-2010-0218) and revealed in a current Hydro Ottawa rates case (EB-2010-0133). VECC maintained that this new information showed that CDM savings are less than half of that reflected in the original IPSP documentation.

Accordingly, VECC submitted that it would be reasonable to assume a cumulative CDM impact for 2011 of no more than 1868 MW, as opposed to the 2486 MW assumed by Hydro One. For 2012, it would be reasonable to assume a cumulative CDM impact of no more than 2377 MW, as opposed to the 3064 MW assumed by Hydro One.

VECC also noted that Hydro One was unable to provide any details as to how the peak MW savings attributed to each type of CDM program was translated into average monthly MW savings (as this information was not provided by the OPA). VECC submitted that Hydro One has the responsibility to obtain sufficient supporting details so it can satisfy both itself and other participants in these proceedings that CDM has been properly incorporated into its load forecast.

CCC supported the VECC submissions, indicating that it is critical for Hydro One to use the best available information regarding the impact of CDM programs in the development of its load forecast.

In its reply argument, Hydro One submitted that VECC's argument relied on 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.

It is Hydro One's position that the OPA's CDM peak impact found in the Hydro Ottawa evidence demonstrates that the CDM peak impact Hydro One used in the load forecast is consistent with the latest information from the OPA.

Consequently, Hydro One submitted that CDM impacts have been appropriately reflected in its load forecast.

## **Board Findings**

The Board notes that the only issue raised regarding the load forecast proposal concerns CDM impact over the relevant time frame. This is not the first time that accounting for the effects of CDM has proven to be elusive. The Board has recently directed Hydro One Distribution to provide information to the Board and the intervenors respecting the accuracy of its assumptions regarding CDM effects (EB-2009-0096). It is clear from Hydro One's evidence in this case that the OPA estimates of impacts are still rooted in the evidence filed in support of the IPSP in 2007. This evidence should be updated to reflect the most current estimates.

It appears that the OPA has provided some revisions to adjust the assumed CDM impacts as reflected in the evidence filed in a recent Hydro Ottawa rates case (EB-2010-0133), but those revisions were not tested in that case, given that the case was dismissed, nor was the rationale for the revised assumptions detailed. The revisions reflected in the Hydro Ottawa case are quite substantial, and if implemented in this case

would result in a significant reduction in anticipated CDM effects. But there does not appear to be an evidentiary basis in this case that would allow the Board to adopt them.

Over the last number of years utilities across the province, including Hydro One Distribution, have spent very considerable sums of ratepayer or taxpayer money in pursuit of the Government's conservation and demand management goals. Recently, the government has intensified this activity through the establishment of specific CDM targets on a distributor by distributor basis. While each distributor has its own specific target for CDM reductions, these specific goals are derived by allocating a global target to the individual distributors. While the budgeting process for distributors to pursue these CDM goals is not finalized, it is clear that very substantial amounts of money will be required to achieve the targets established by the Government.

The Board is concerned that in this environment of increased pressure to pursue CDM, attended as it is with corresponding costs, that there does not appear to be a broadly accepted methodology in place to identify the reasonably anticipated effects of any CDM program on the throughput of the respective distribution or transmission systems.

Estimates and forecasts were an inevitable feature of the early stages of an increased interest in conservation and demand management performance in the province. But we are now at a stage where the stakes are higher, the amounts of money necessary to meet targets has increased, and yet our ability to measure this activity is unacceptably primitive. The Board notes that there is an intention to develop more capable methods of assessing the actual impacts of CDM programs, which will be of direct relevance to load forecasting, and in developing an appropriate context in which to assess the cost-effectiveness of specific measures undertaken in this area of activity. The Board recognizes that the OPA is engaged in refining its abilities to evaluate, measure, and verify the CDM programs it intends to offer to LDCs pursuant to the government's latest directives. For the purposes of establishing credible load forecasts, much more acuity than is currently available is needed.

In the circumstances of this application, the Board is prepared to accept Hydro One's CDM estimates for the purposes of its load forecast. The Board recognizes that load forecasting is subject to a number of uncertainties, and attempting to account for the effects of CDM adds another layer of uncertainty. It is unpredictable whether these various uncertainties will act cumulatively or in opposition to each other in their effect on throughput. As a result, the Board accepts Hydro One's forecast, as the evidentiary record in this case does not offer a more certain number.

However, the Board considers it advisable to ensure that steps are taken to improve the assessment of CDM effects going forward, so that subsequent load forecasts can be better informed and predicated on substantiated empirical data.

Accordingly, the Board directs Hydro One to work with the OPA in devising a robust, effective and accurate means of measuring the expected impacts of CDM programs

promulgated by the OPA. It is important that the terms of reference for the development of this methodology should, to the extent possible, be devised with input from and consultation with a sufficiently broad range of stakeholders so as to ensure that the resulting product has credibility within the sector. The Board requires that this work be performed within a timeframe so that its results will inform the Company's next rate application. Of course, if the development of the methodology results in interim learnings, it is expected that they will be shared broadly. The Board notes that there may be CDM programs that are additional to those promulgated by the OPA, but it is reasonable to assume that they will not form a large part of the overall CDM picture, and that those programs will also benefit from the analytical approach which emerges from the effort.

## OPERATIONS, MAINTENANCE AND ADMINISTRATION EXPENSE

Hydro One Transmission's OM&A budget is grouped into different investment categories: Sustaining, Development, Operations, Customer Care, Shared Services and Taxes Other than Income Taxes. The table below sets out Hydro One's historic, bridge and test years OM&A expenses. The 2011 increase over the 2010 level approved (\$426.2 million) in the last Hydro One Transmission proceeding (EB-2008-0272), is 2.4%.

### Transmission OM&A Expenditures 2009 – 2012 (\$ million, including % variance from prior year)

Category	Historic			Bridge	Test	
	2007	2008	2009	2010	2011	2012
<b>Sustaining</b>	<b>205.9</b>	<b>187.5</b>	<b>213.5</b> 13.9%	<b>224.4</b> 5.1%	<b>233.0</b> 3.8%	<b>243.1</b> 4.3%
<b>Development</b>	<b>8.4</b>	<b>9.2</b>	<b>14.0</b> 52.2%	<b>19.0</b> 35.7%	<b>18.2</b> -4.2%	<b>18.9</b> 3.8%
<b>Operations</b>	<b>54.0</b>	<b>51.7</b>	<b>52.6</b> 1.7%	<b>62.1</b> 18.1%	<b>66.3</b> 6.8%	<b>68.2</b> 2.9%
<b>Customer Care</b>	<b>1.2</b>	<b>1.3</b>	<b>0.9</b> -30.8%	<b>1.1</b> 22.2%	<b>1.1</b> 0.0%	<b>1.2</b> 9.1%
<b>Shared Services &amp; Other</b>	<b>80.9</b>	<b>59.4</b>	<b>70.8</b> 19.2%	<b>58.6</b> -17.2%	<b>46.9</b> -20.0%	<b>46.4</b> -1.1%
<b>Tax other than Income Tax</b>	<b>62.4</b>	<b>64.8</b>	<b>65.2</b> 0.6%	<b>69.4</b> 6.4%	<b>70.8</b> 2.0%	<b>72.2</b> 2.0%
<b>Total</b>	<b>412.9</b>	<b>373.8</b>	<b>417.0</b> 11.5%	<b>434.6</b> 4.2%	<b>436.3</b> 0.4%	<b>450.0</b> 3.1%

Source: Exhibit C1/Tab2/Schedule 1

The expenses presented in the table do not include proposed OM&A Development spending of \$132.7 million to be captured in a deferral account for 2010, 2011 and 2012 for the 16 specific Green Energy Development projects in the "IPSP and Other Preliminary Planning Costs Deferral Account".

### OVERALL OM&A

OM&A expenses are projected to increase by 0.4% in test year 2011 over the 2010 bridge year and by a further 3.1% in 2012. Hydro One stated that the test year expenditures are largely required to address the increasing maintenance requirements of an aging and expanding transmission system. Hydro One stated that increased spending is also required for the initiation of Smart Zone development work. The

increases sought are partially offset by decreases to Development costs and increased Cornerstone savings within the Shared Services category.

Hydro One indicated that it had made reductions of \$19.4 million in OM&A costs in response to the Minister's letter of May 5, 2010 from what was the originally planned proposal for 2011. These OM&A reductions consisted of a \$12.9 million reduction in Sustaining OM&A and a reduction of \$6.5 million in Shared Services and Other Costs. In addition, for 2012, related reductions were a \$11.3 million decrease in Sustaining and an \$8.6 million decrease in Shared Services & Other Costs, for a total 2012 OM&A reduction of \$19.9 million. No reductions from the Company's original proposal were made in the Development and Operations OM&A budgets for either test year.

SEC argued that the overall level of OM&A spending proposed by Hydro One is too high. In its argument, SEC initially focused on what it referred to as Hydro One's controllable costs; that is: Sustainment, Development, Operations and Customer Care. These areas showed a cumulative increase of \$81.8 million over 4 years or 32.8%.

SEC stated that of the \$81.8 million increase, \$49 million was already approved by the Board in its EB-2008-0272 decision; an increase of 19.6%. SEC submitted that the additional increase, a further 13.2% or \$32.8 million over two years, is not reasonable, given the size of the increase approved by the Board in its previous decision.

SEC submitted that in view of the expanded capital expenditure plan, and the shifting of costs from OM&A to capital, it is appropriate for the Board to freeze spending levels and approve an OM&A budget for Sustaining, Development, Operations and Customer Care of \$298.6 million for each of 2011 and 2012. This would reduce the revenue requirement for 2011 and 2012 by \$20.0 million and \$32.8 million respectively.

Board staff noted that the proposed OM&A budget is still \$34.5 million above the Hydro One defined "minimum" requirements for 2011 and \$37 million above "minimum" requirements for 2012. These defined minimum requirements form an integral part of Hydro One's planning process. In that process the Company has established a "minimum" spending level for numerous categories of project spending. The minimum levels represent a level of spending capable of avoiding major implications for the reliability and safety of the system for a defined period of time.

Board staff submitted that although Hydro One has made reductions to OM&A for the test years between its originally proposed levels to the current request, the evidence suggests that further reductions in OM&A spending could be made particularly in the areas of Development and Operations Costs (excluding compensation), Compensation Costs and Pension Costs. Board staff also noted that a number of cost effectiveness measures were discussed in the hearing, and these showed that Hydro One could improve cost performance. In summary, staff suggested that an additional 2-3% could be reduced from OM&A costs in addition to compensation related reductions. These submissions were supported by several intervenors.

VECC also noted that there were no reductions to the Operations and Development OM&A budgets and agreed with Board staff in saying that the overall OM&A levels were well above the 'minimum' levels. Regarding performance measures, VECC also submitted that Hydro One is not demonstrating improved productivity performance. VECC submitted that the Board should reduce the OM&A envelopes closer to minimum levels for the test years.

Intervenors also made comments on specific increases in categories of costs sought in the application.

## **Board Findings**

While the Board notes that Hydro One is seeking a less significant increase in its OM&A as compared to previous years and applications, the Board finds that there is still room for further cost reductions to be made.

The Board is mindful that in previous decisions fairly significant increases have been approved by the Board. Those increases were considered by the respective panels of the Board hearing those cases, in light of the circumstances and evidence before them. Previously awarded increases do not in and of themselves support reductions in this case. This case must be considered in light of its particular circumstances and the evidence before the Board. The Board does not accept SEC's proposal to freeze spending in areas Sustaining, Development, Operations and Customer Care on the basis of the magnitude of increases approved in previous applications.

In recent decisions the Board has approved a gross amount, commonly referred to as the "envelope" to support the Company's OM&A activities. In this way, the Board provides the Company with the funding it believes has been supported by the evidence, without specifically directing the Company as to how the funds should be allocated among the various categories of OM&A spending. It is the Board's view that within the envelope the Company is far better able to make those kinds of allocations than the Board. The Board's envelope approach is also appropriate in this case because it appeared there was an apparent lack of sufficient evidence in several areas that would make it difficult for the Board to quantify disallowances in specific categories of spending.

There are exceptions. For example, in this proceeding the Board will make a specific finding with respect to Compensation. Otherwise the Board's commentary on the various categories of spending should be regarded as strongly influential to the Company as it makes its spending decisions, but not directive.

In this case the Board's concern about the proposed spending level relates directly to the Company's ongoing issues with productivity. The Mercer (Canada) Limited and Oliver Wyman Study ("Mercer Study") filed in the last transmission rates proceeding

(EB-2008-0272) , which is still the only empirical evidence respecting productivity before the Board, indicates that the Company is lagging behind its peers with respect to its productivity. Specifically, the Mercer study indicates that the Company is 17% above the median of its comparators. It is the Board's view that the spending level approved within the envelope must reflect the Board's concern about this issue. Some aspect of this issue can be addressed directly within the Compensation category of spending. But in other areas as well, the Board is determined to ensure that the Company improves its overall performance.

Accordingly, the Board will reduce the Company's OM&A envelope by 3% for 2011 and 4% for 2012 from applied-for levels. These reductions are to include the impact of the reductions in compensation as noted below and are to be calculated after the changes that the Board has ordered regarding HST impacts.

The Board notes that this will leave the overall OM&A levels substantially above the minimum levels, and the envelope approach reflects the absence of precision in the application as filed.

The Board also notes that the Company has also agreed to make adjustments to its PILs calculations related to Apprenticeship, Co-op Education and SR&ED Tax Credits, the Ontario Small Business Deductions and CCA changes. The Board concurs with these adjustments.

## **SUSTAINING**

Sustaining OM&A consists of expenditures required to maintain transmission facilities at appropriate levels of reliability and service quality, and to satisfy legislative, regulatory, environmental and safety requirements. There are three categories within sustaining OM&A:

- Stations – which funds the work required to maintain assets within transmission stations including power transformers, circuit breakers and ancillary systems;
- Lines – which funds the work required to maintain 28,000 circuit kilometres of overhead transmission lines and 270 circuit kilometres of underground transmission lines; and
- Engineering and Environmental Support – which funds the work related to managing transmission assets including management of records and drawings, and services that provide technical expertise not available within Hydro One.

The historic, bridge and test year expenditures are summarized in the table below.

**Sustaining OM&A (\$ millions)**

	Historic			Bridge	Test	
	2007	2008	2009	2010	2011	2012
<b>Stations</b>	150.0	133.9	151.5	164.9	170.6	176.1
<b>Lines</b>	47.0	43.5	49.4	48.0	51.4	55.3
<b>Engineering &amp; Environmental Support</b>	8.9	10.1	12.50	11.5	11.0	11.8
<b>TOTAL</b>	205.9	187.5	213.5	224.4	233.0	243.1

Source: Exhibit C1/Tab2/Schedule 3

In response to the Minister of Energy's letter of May 5, 2010 Hydro One reduced projected Sustaining OM&A expenditures by \$12.9 million in 2011 and \$11.3 million in 2012 over what was in the Company's original proposal for these test years.

Overall, Sustaining OM&A is still forecast to increase by 3.8% in 2011 over bridge year spending in 2010 and by a further 4.3% in 2012. Hydro One stated that the increased expenditures are required to meet the increased cost pressures as a result of new Environment Canada regulations for PCBs, new North American Electric Reliability Corporation regulatory requirements and aging assets that are increasing maintenance demands to maintain reliability and safety at current levels.

Energy Probe accepted Hydro One's evidence justifying these increased expenditures for Sustaining OM&A, recommending the Board approve the total Sustaining OM&A expenditures.

PWU submitted that it has reservations as to the adequacy of the proposed levels of Sustaining spending in the test years but found that Hydro One had struck a minimally acceptable balance between its ongoing operational needs and current rate impacts. The PWU indicated that a cut to Sustaining spending would exacerbate the "already dire state" of the Hydro One assets.

The PWU states that in recognizing the value of the reductions made by Hydro One in the area of Sustaining OM&A, the Board cannot limit its focus to the reduction in consumer rate impact but also has to be mindful of its statutory responsibilities that require it to assess any potential adverse impacts of reductions made to the work plan on Hydro One's ability to maintain and improve system reliability and quality of service. PWU goes on to suggest that reductions in Sustaining OM&A from the original proposal could contribute to a backlog of sustaining investment that would have to be undertaken in the future at a higher cost to future generations of consumers.

Board staff made no comments on the specific levels of OM&A expenditures for the Sustaining category.

In its argument over the proposed increases to controllable costs, SEC suggested that the Board freeze sustaining OM&A budgets at current levels.

The Board recognizes the importance to the Company of spending an appropriate amount on Sustaining OM&A to ensure that its transmission system is appropriately maintained and robust. The Board does not find it appropriate to direct Hydro One in its determination as to what is required in this area, provided there is sufficient evidence in any given case to support the Company's plans. The Board finds that Hydro One's overall approach to sustaining OM&A is reasonable.

## DEVELOPMENT

Development OM&A provides funds for Research, Development and Demonstration ("RD&D") on emerging technologies, for standards development activity and for Smart Zone Development.

The historic, bridge and test year expenditures are summarized in the table below.

**Development OM&A (\$ millions)**

	Historic			Bridge	Test	
	2007	2008	2009	2010	2011	2012
<b>Research Development &amp; Demonstration</b>	4.4	3.0	6.0	6.3	6.4	6.6
<b>Standards Development</b>	4.0	6.2	7.9	8.7	7.8	8.3
<b>Smart Zone Development*</b>				<b>4.0</b>	<b>4.0</b>	<b>4.0</b>
<b>TOTAL</b>	8.4	9.2	14.0	19.0	18.2	18.9
<b>Development Work for Transmission Projects</b>	0	0	1.9	8.2	35.7	46.7

Source: Exhibit C1/Tab2/Schedule 4

\*New development initiative

The line in the table above entitled "Development Work for Transmission Projects" is that category of spending which is intended to be reflected in a proposed deferral account respecting Green Energy Programs.

CCC submitted that the RD&D budget was not supported with a project by project analysis. In addition, CCC argued that Hydro One did not provide a business case for Smart Grid Development. As a result of the insufficient evidence provided, CCC submitted that the Board should reduce the allowed Development budgets in these two areas by half; RD&D should be reduced to \$3.2 million in 2011 and \$3.3 million in 2012.

With respect to Smart Grid budgets, CCC concluded they should be reduced to \$2.0 million in 2011 and \$2.0 million in 2012.

Energy Probe accepted that some level of Smart Grid research is necessary to prepare the grid for renewable generation, but it contended that the \$4 million in expenditures proposed under Development OM&A were not sufficiently justified in the evidence and advocated for a reduction of \$2.0 million for each test year. Energy Probe noted that costs actually incurred in this category as of June 2010 were zero.

VECC also commented on the paucity of evidence and the absence of a business case analysis in support of Hydro One's RD&D and Smart Grid budgets. While the RD&D budget is intended to enable the testing of the feasibility of emerging technologies, VECC notes that Hydro One conceded that the expenditures are set out at a high level with no definitive project by project analysis. VECC supported other intervenors' conclusions that these budgets should be reduced by 50%, for a total reduction of \$5.2M per test year.

In its argument over the proposed increases to controllable costs, SEC suggested that the Board freeze Development OM&A budgets at current levels. Board staff noted that no cuts were made in Development and Operations budgets despite the growth of these budgets for both areas and in some cases presumed reduced development work load.

Hydro One rejected the idea that there was a direct correlation between Development OM&A spending and Development Capital spending. It argued that RD&D expenditures are also made in conjunction with many partner organizations and cutting expenditures in research and development would jeopardize Hydro One's capability to assess emerging technologies and make informed investment decisions. In its view any cuts would compromise existing contractual obligations and current projects. Hydro One underlined that Smart Grid work was also essential and necessary.

The Board finds that the budget sought for Development OM&A, with exception of the development work for transmission projects, is quite modest. The Board agrees with Hydro One that there is a need for this organization, perhaps above all others, to have a reasonably vibrant RD&D activity. However the Board shares intervenor concerns that the Company has not provided project by project justification for the planned spending.

The Board accepts Energy Probe's recommendation that Hydro One be required to file a detailed report in its next transmission rates application describing the OM&A activities for Smart Grid undertaken along with an analysis of the results achieved and a description of how they relate to the transmission system.

## OPERATIONS

The Operations OM&A program represents the annual expenditures required for the Central Transmission Operations function, operated out of Hydro One's Ontario Grid Control Centre. The Transmission Operations function is concerned with the real time operations of the Hydro One Transmission system equipment, including the monitoring, control, detection and response to equipment operational issues.

### Operations OM&A Allocated to Transmission (\$ Millions)

	Historic			Bridge	Test	
	2007	2008	2009	2010	2011	2012
Operations	28.4	29.1	30.2	31.8	32.7	32.8
Operations Support	18.3	16.6	16.6	22.6	24.8	25.9
Environment, Health and Safety	2.9	1.9	1.5	2.6	3.5	4.0
Large Customer & Generator Relations*	4.3	4.1	4.3	5.2	5.3	5.5
<b>Total</b>	<b>54.0</b>	<b>51.7</b>	<b>52.6</b>	<b>62.1</b>	<b>66.3</b>	<b>68.2</b>

Source: Exhibit C1/Tab2/Schedule 5

\*Due to an organization change, in the previous EB-2008-0272 application these costs were included in Shared Services in the Asset Management organization.

In the Operations category, no reductions from the Company's original proposal were made, and the Operations OM&A budget grows from the 2009 approved level of \$53.7 million to \$66.3 million in 2011, an increase of 23% in two years. Board staff submitted that the Applicant has not demonstrated that reductions in this category were properly considered, nor is there an explanation as to why spending in this area could not be reduced.

The Board notes that the Company did not provide, for the purposes of its proposed Operations spending, any specific reductions in light of the Minister's letter. Hydro One does not appear to have subjected Operations spending to the same depth of analysis as other areas of spending.

## SHARED SERVICES AND OTHER

A centralized shared services model is used to deliver common services to Hydro One Networks Inc. and its affiliates. These shared services include Asset Management, Information Technology, and Common Corporate Functions and Services ("CCFS"). CCFS services include corporate management, finance, human resources, corporate communications, legal, regulatory affairs, corporate security, and internal audit.

**Allocated Transmission Shared Services and Other OM&A (\$ millions)**

	Historic			Bridge	Test	
	2007	2008	2009	2010	2011	2012
Common Corporate Functions and Services	64.1	64.5	71.8	81.3	79.7	86.6
Asset Management	25.9	31.8	40.0	33.0	35.5	36.0
Information Technology	46.2	50.7	56.2	68.1	67.5	68.5
Cornerstone	2.7	1.5	4.0	(9.4)	(12.5)	(21.4)
Cost of Sales	14.5	20.5	13.5	15.8	14.9	8.5
Other OM&A	(72.5)	(109.6)	(114.7)	(130.3)	(138.3)	(131.8)
<b>Total</b>	<b>80.9</b>	<b>59.4</b>	<b>70.8</b>	<b>58.6</b>	<b>46.9</b>	<b>46.4</b>

Source: Exhibit C1/Tab2/Schedule 6

In the specific area of Shared Services, VECC submitted that while Hydro One provided reasonable explanations for some of the cost increases, there was no evidence of constraint being applied.

In particular, VECC submitted that one area that warrants a reduction is the \$5 million increase in Corporate Communications related to GEGEA activities. VECC argued that given the uncertainties about the resumption of work on GEGEA related projects these costs should be removed from the OM&A budget and any required expenses recorded in a deferral account.

Hydro One submitted that a number of intervenors such as Energy Probe, AMPCO, PWU and Board staff either supported or had no comments about Shared Services OM&A. Only CCC and VECC urged a reduction to Shared Services OM&A related to a particular area of spending.

The Board is concerned that the Company has not provided any explanation as to why cost reductions ought not to be enhanced in this category of spending.

**COMPENSATION**

Hydro One projects that payroll for 2011 will be \$794.9 million and \$832.6 million for 2012. This reflects the combined compensation costs for the transmission and distribution businesses. Hydro One stated that due to the nature of its integrated transmission and distribution workforce, separate workforce and compensation data for the transmission business is not available.

**Year End Hydro One Networks Inc Payroll (Tx and Dx)**

	Historic			bridge	Test	
	2007	2008	2009	2010	2011	2012
<b>Compensation</b>	495.5	566.2 14.3%	623.2 10.1%	734.9 17.9%	794.9 8.2%	832.6 4.7%

Source: Exhibit C1/Tab3/Schedule 2

\* This payroll reflects compensation costs associated with year-end headcounts for all EPSCA, PWU, Society and MCP Transmission and Distribution staff.

Hydro One stated that while it has strived to reduce compensation levels in response to the Board's previous decisions on transmission and distribution (EB-2008-0272 and EB-2009-0096), it faces significant unique Human Resource challenges as a result of:

- Shortages of skilled workers
- Significant portion of current workforce retiring
- The Company's increased work program
- Tight competition for electricity sector workers.

In its evidence, Hydro One described how it meets its challenges through its staffing strategy, recruitment and training. The Company maintains however, that the overall compensation package remains a product of historical factors as well as current and future challenges.

Approximately 90% of the workforce is unionized. Despite efforts and progress to minimize costs and increase productivity through collective bargaining, Hydro One maintains that its ability to reduce compensation in its unionized environment is limited. The revenue requirement reflects a 3% increase in 2011 and 2012 for the PWU members and a 2.5% increase for Society members. This was subject to considerable cross examination and argument from intervenors. For its management staff, Hydro One stated that it has implemented a zero percent increase over the next two years.

BOMA/LPMA and Board staff suggested that the Board require Hydro One to uphold the intent of the Government's net zero policy to PWU members when the current collective agreement expires in March 2011. If Hydro One is unable to negotiate a net zero compensation increase, BOMA/LPMA submits that any increase in cost should be borne by the shareholder. BOMA/LPMA also suggests that the Board disallow amounts consistent with the Board's decision in Hydro One's previous transmission proceeding (EB-2008-0272) for both 2011 and 2012.

The Board disallowed \$4 million in compensation costs in the previous transmission proceeding. While the Board did not order a specific reduction in compensation in the recent distribution proceeding (EB-2009-0096), it did establish an overall OM&A envelope and observed that compensation cost, including growth in head count, are one

of the areas in which Hydro One must take future action to control expenditure increases.

Board staff relied mainly on the results of the Mercer study to advocate for a reduction in compensation costs of \$6 million in 2011 and \$7 million in 2012. Hydro One's evidence was that the Mercer study was still valid in this case and indicated that compensation reductions of \$6.2 million and \$6.9 million for the two test years is comparable to the Mercer-related reductions ordered by the Board in the previous transmission rates case. Staff also highlighted that voluntary exits from the Company were at very low levels, and that high levels of new hiring were indicative that salary levels were not an impediment to hiring.

Hydro One provided a comparison of its compensation to OPG, IESO and Bruce Power and argued that it has demonstrated its ability to constrain compensation increases relative to the other companies despite being in direct competition with them for labour.

SEC's intervention focused on headcounts and compensation levels. SEC noted the fact that Hydro One had not updated its work plan with respect to headcount, and that Hydro One had indicated that the current plan is high by 40-50 positions. Over the five year period from 2007 Hydro One is adding, on average over 600 employees per year.

VECC and SEC also suggested that Hydro One has been overestimating the number of retirements over a number of years. SEC suggested that the problem of retirements never really seems to materialize. With regard to headcount, SEC suggested that 500 or more of the 1230 additional employees proposed for 2010 are in excess of reasonable needs, especially given the additional net 578 to be added in 2011 and 150 in 2012. At the average wage level of \$93,153 cited by Hydro One, and without including non-wage compensation, SEC submitted that this amounts to more than \$46 million per year during the test period. If it is assumed that 50% is applicable to the transmission side of the Company's business this would amount to a \$23 million per year reduction in compensation costs.

SEC agreed with the Board staff submissions to the effect that costs due to compensation should be reduced by \$6.2 million and \$6.9 million respectively for the two test years in light of the Mercer study findings.

In its evidence, Hydro One referenced a series of comparisons between position descriptions used in its system, and those employed by relevant comparators. SEC questioned these benchmarking comparisons provided by Hydro One, referencing the fact that Hydro One used the Powerline Maintainer position at \$35.46 an hour for the comparison, when it would have been more appropriate to use the position of Regional Maintainer (\$38.30).

SEC proposed reductions to OM&A totaling \$52.8 million including the human resource reductions discussed above.

VECC submitted that Hydro One's total compensation costs are not in compliance with the Board's Direction in its decision in the EB-2008-0272. VECC noted that Hydro One is still not able to provide an estimate of total compensation costs that relates to the applied-for revenue requirement, including an appropriate allocation as between its Distribution business and its Transmission business.

VECC suggested that the primary driver of higher 2011/2012 compensation costs is increases in headcount. Second is the fact that salaries continue to be above industry norms based on the Mercer Compensation studies. The third reason for higher compensation costs is that salaries are increasing at a rate above inflation.

VECC submitted that Hydro One has historically overstated headcounts and recommended the headcounts for the test years be reduced by 50 FTEs which, using an average base pay of \$75,000, would result in OM&A costs reductions of \$3.75 million in each test year. In addition, VECC also argued that the findings of the Mercer study justify reductions of \$6.2 million and \$6.9 million respectively for the two test years.

With regard to the wage comparison evidence, VECC suggested that to be meaningful, a wage comparison survey should include annual cost of living data for the comparator group. VECC submitted that Hydro One should be directed to provide a new wage comparison study that includes cost of living data.

VECC also submitted that Hydro One had underestimated the Apprenticeship Training tax credits by at least \$1 million in each test year.

On the issue of pensions, Board staff expressed concern with higher pension costs and encouraged the Board to direct Hydro One to move toward higher employee contribution levels to the pension plan in addition to taking steps to increase pension plan performance from the 61st percentile level that Hydro One had so far achieved. VECC also agreed with Board staff that the share of employee contributions to the pension plan should be brought in line with public sector norms of 50%.

## **Board Findings**

The Board notes Hydro One's efforts to address compensation issues highlighted in previous proceedings. However, the Board continues to be concerned about the Company's ability to control the growth in head count and labour cost increases, particularly within its collective bargaining environment. Hydro One has consistently stated that its ability to decrease labour costs through collective bargaining is limited given the increases that have been negotiated in agreements for other electricity

utilities. However, the Board agrees with SEC's assessment that the compensation levels at Hydro One have the tendency to push up the amounts that every other utility in Ontario has to pay their staff. The Board does not accept Hydro One's statement that its ability to moderate wage increases is limited in light of wage increases awarded in other electricity utilities. This circularity of dependence between LDCs and Hydro One is obvious and of concern to the Board.

The Board also shares intervenors' concerns that Hydro One's compensation costs are still 17% above the market median and that proposed increases in headcounts are excessive. Central to this problem is the lack of any measureable increases in productivity. In its previous decision, the Board indicated that it did not accept that the productivity portion of the Mercer study could be relied on. The Board still finds this to be so.

The only reasonable conclusion that can be drawn from the evidence in the current case is that there appears to be a disconnect between the compensation levels as reflected in union settlements and the productivity being achieved by the Corporation. This must change.

The Board directs Hydro One to revisit its compensation cost benchmarking study in an effort to more appropriately compare compensation costs to those of other regulated transmission and/or distribution utilities in North America. It is important that the Company be in a position to provide more robust evidence on initiatives to achieve a level of costs per employee closer to market value at its next transmission rate case. The Board will expect compensation increases to be matched with demonstrated productivity gains. Hydro One will risk not recovering all of its compensation costs if it fails to tie compensation cost increases to measureable gains in productivity.

To that end, the Board directs Hydro One to consult with stakeholders about how the Mercer study should be updated and expanded to produce such analyses.

While the Board has approved an overall OM&A envelope and given Hydro One the freedom to apply that spending according to its own priorities, the Board expects that Hydro One will revisit the proposed increases allocated to compensation.

This should provide a signal for upcoming bargaining. With respect to pension contributions, it is the Board's view that in subsequent applications, Hydro One must demonstrate measurable progress towards having its pension contributions reflect those prevailing in the public sector generally. The evidence suggests that an employee contribution level of 50% is the norm.

## TAXES OTHER THAN INCOME TAXES

Hydro One projected property taxes of \$61.8 million in 2011 and \$63.2 million in 2012. This is an increase of 2% in both 2011 and 2012 for the cost of property tax, indemnity payments and rights payments.

### Taxes Other than Income Taxes (\$millions)

	Historic			Bridge	Test	
	2007	2008	2009	2010	2011	2012
<b>Property Tax</b>	55.2	57.3	58.3	60.4	61.8	63.2
<b>Indemnity Payment</b>	4.5	4.5	4.5	4.5	4.5	4.5
<b>Rights Payment</b>	2.8	2.7	2.4	4.5	4.5	4.5

Source: Exhibit C1/Tab2/Schedule13

Based on the fact that year-to-date June 2010 property taxes are lower than forecast, BOMA/LPMA submitted that test year amounts for property taxes should be reduced by \$0.7 million in each year. In its response Hydro One provided an explanation regarding the property tax calculation for the test years, revealing a one time credit due to a tax appeal in 2009.

Hydro One indicated that Rights Payments are currently under review and that the Company is unable to predict the outcome of the timing. The amounts included are budgets used for planning purposes. BOMA/LPMA submitted that given the uncertainty around the quantum and timing of any changes to Rights Payments, Hydro One should be required to maintain current costs of \$2.8 million for the test years. BOMA/LPMA also indicated that it did not oppose a variance account to track actual payments.

### Board Findings

While the Board will not require a specific reduction in Rights Payments, it will establish a variance account to track the difference between the amount provided for in the revenue requirement and the actual payments.

### Harmonized Sales Tax

The 8% Ontario provincial sales tax ("PST") and the 5% Federal goods and services tax ("GST") were harmonized effective July 1, 2010, at 13%, pursuant to Ontario Bill 218, which received Royal Assent on December 15, 2009.

Prior to this event the PST would have been included in Hydro One's OM&A expenses and capital expenditures. PST therefore would have been included in Hydro One's revenue requirement and therefore recovered from ratepayers through UTR rates.

Now that PST and GST are harmonized, Hydro One will pay the HST on purchased goods and services and is eligible to claim a full input tax credit (“ITC”) on the PST portion paid. Therefore, Hydro One will no longer incur that portion of the tax that was formerly applied as PST.

In the majority of 2010 electricity rate applications the Board ordered the establishment of a deferral account to record the amounts that were formerly incorporated as the 8% PST on capital expenditures and OM&A expenses incurred, but which would now be eligible for an ITC. This treatment was to be implemented to reflect amounts arising between July 1, 2010, the date the harmonization was effected and the time of their next cost of service rebasing application.

In response to an interrogatory, Hydro One initially estimated the reduction in OM&A attributable to the elimination of the PST to be \$5.2 million in 2011 and \$5.3 million in 2012. The reductions in capital expenditures were estimated to be \$42.6 million in 2011 and \$35.8 million in 2012. The revenue requirement impact of these combined reductions is approximately \$10 million in each year. (Capital expenditure reductions were estimated to contribute \$4 million to revenue requirement impact and OM&A accounted for the remaining \$6 million.)

Hydro One initially proposed to record the revenue requirement impact of the estimated reduction in its proposed 2011 and 2012 expenditures in deferral account 1592. However, during the course of the oral hearing and subsequently in its final argument, Hydro One indicated that it could reflect the cost impacts between HST and PST in the revenue requirement. The Company indicated that a deferral account was no longer warranted. Hydro One also indicated that it had conducted further analysis of the reduction in revenue requirement driven by harmonization of GST and PST.

Hydro One also updated its estimates of this issue since the oral hearing, revising its estimates of the impacts on revenue requirement 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.

Several intervenors submitted that the cost impact between the HST and PST should be reflected in revenue requirement so that savings can be passed on to customers in the test years.

CCC asserted that the difference between estimated and actual reductions in OM&A should be recorded in a variance account.

BOMA/LPMA argued that the reductions in the test-year revenue requirement should be passed onto customers, especially in an environment where rates are rising significantly. BOMA/LPMA recommended the use of a variance account to capture any variances in the projected reductions in revenue requirement. BOMA/LPMA also noted

that it was unclear from the evidence if the reductions in capital expenditures for the last six months of 2010 (i.e. post July 1, 2010) are reflected in the calculation of the test year rate base. BOMA/LPMA estimated the impact to be approximately \$1 to \$2 million in the test years.

BOMA/LPMA and VECC also noted that the effect of the introduction of the HST is to reduce the working capital amounts from \$7.1 million to \$0.8 million in 2011 and from \$5 million to \$3.4 million in 2012. These intervenors argued that the reductions in working capital should also flow through to customers.

In reply argument, Hydro One agreed to pass on the savings to customers by reducing the test year revenue requirement. Hydro One submitted that a variance account was not required, arguing that it would not be able to determine the auditable difference between the estimated and actual impacts given the fundamental difference between PST and HST and the significant volume of transactions which are affected.

### **Board Findings**

The Board finds that after adjusting the OM&A envelope in accordance with this decision, Hydro One will recalculate the resulting HST-related reduction in OM&A and recognize this reduction in its revenue requirement.

## RATE BASE AND CAPITAL EXPENDITURES

Hydro One Transmission's forecast rate base for the 2011 test year is \$8,378.5 million and for the 2012 test year is \$9,134.6 million. The 2011 rate base is 9.7% higher than the 2010 Board approved rate base of \$7,636 million. In 2012, the rate base is forecast to grow by 9% compared to 2011.

The Working Capital Allowance for 2011 is \$24.5 million and \$26.7 million for 2012.

Historical and forecast capital expenditures by major cost category are summarized in the table below. Hydro One also proposed capital expenditures of \$126.7 million in 2011 and \$198.1 million in 2012 related to projects in its Green Energy Plan. All Green Energy Plan capital investments are included in the Development category and are addressed separately in this decision.

### Transmission Capital Expenditures 2009 – 2012<sup>1</sup>

(\$ million)

Category	<u>Actual 2009</u>	<u>Bridge 2010</u>	<u>Test 2011</u>	<u>Test 2012</u>
Sustaining	300	308.3	424.9	443.4
	7%	3%	38%	5%
Development	516.2	537.9	617.2	456.8
	66%	4%	15%	-26%
Operations	20	10.1	44.3	57.4
	-13%	-50%	339%	30%
Shared Services	81.5	73.6	66.3	50.6
	-9%	-10%	-10%	-24%
<b>Total Capital Expenditure Budget</b>	<b>917.8</b>	<b>929.9</b>	<b>1,151.8</b>	<b>1,008.3</b>
	30%	1%	24%	-12%
<b>Total (Excluding Green Energy Plan)<sup>2</sup></b>	<b>917.8</b>	<b>929.9</b>	<b>1,025.1</b>	<b>810.1</b>
	30%	1%	10%	-21%

<sup>1</sup> Exhibit D1/Tab3/Sch1 p. 2

<sup>2</sup> Reflects the removal of the Green Energy Plan capital investments of \$126.7 million in 2011 and \$198.1 in 2012 from the Development capital budget.

The submissions of intervenors primarily focused on the appropriateness of the overall capital expenditure budget. Other issues that were raised dealt with adjustments to the various components of rate base.

The following issues are addressed in this chapter:

- Overall Capital Expenditures
- Materials and Supplies Inventory
- Recognition of HST savings on components of rate base
- Allowance for Funds Used During Construction

## OVERALL CAPITAL EXPENDITURES

Capital expenditures are forecast to increase by 24% in 2011 and decrease by 12% in 2012. Excluding Green Energy Plan investments, capital expenditures are forecast to increase by 10% in 2011 and decrease by 21% in 2012.

Due to the multi-year nature of transmission projects, not all capital expenditures will be booked to the test-year rate base. Only a portion of the capital expenditures for which Hydro One has sought approval will be in service in the test years. In-service capital additions in 2011 are estimated to be \$870.6 million and \$1,618.8 million in 2012. In-service capital additions in 2010 are estimated to be \$798.2 million. Excluding Green Energy Plan capital additions<sup>3</sup>, the capital additions are approximately \$859.2 million in 2011 and \$1,420 million in 2012. These capital additions represent a year over year increase of 8% in 2011 and 65% in 2012. The significant increase in 2012 capital additions is partly due to the addition of the Bruce to Milton project in rate base.

PWU submitted that the capital budget is not sufficient to sustain the current assets and a further disallowance would exacerbate the deterioration of assets. PWU submitted that Hydro One should be required to submit a plan in its next rates proceeding, setting out a sustaining work program with the aim to improve upon the current demographic profile of major asset classes.

Energy Probe submitted the Company had adequately supported its Sustaining, Operations and Shared Services capital budget. Board staff noted that it did not have any specific concerns with Hydro One's capital budget.

VECC and CCC argued that Hydro One had not made sufficient reductions to its revenue requirement, as it was asked to do by the Minister of Energy in his letter to Hydro One dated May 5, 2010. They argued that the spending cuts to the capital plan were *de minimus*. These intervenors argued that the reductions to the budget are due to the deferment of projects as opposed to specific reductions in the budget. VECC noted that in cross-examination Hydro One's witness confirmed that the focus of the

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<sup>3</sup> Green Energy Plan in-service capital additions: \$11.4 million in 2011 and 198.9 million in 2012.

reductions was the OM&A budget, as opposed to the capital budget. VECC submitted that the Company had not made any reductions to the Sustaining Capital budget and noted that these expenditures were still well above the Minimum Level. The Minimum Level of spending is determined by Hydro One's risk-based planning process, referenced above and discussed in more detail at ExA/T12/S5.

AMPCO, BOMA/LPMA and SEC questioned Hydro One's ability to achieve its forecasted capital plan and noted that in recent years Hydro One's actual capital expenditures had been consistently below Board approved levels. In light of the under-spending, AMPCO argued that customers should not be required to pay for capital projects Hydro One is not able to complete. BOMA/LPMA submitted that due to the under spending Hydro One had recovered in rates significant costs which had not materialized. AMPCO noted that in 2007 and 2008 Hydro One's actual capital expenditure was below Board approved expenditure by approximately \$200 million. Similarly, BOMA/LPMA noted that in 2009 and 2010 Hydro One had under-spent by \$150 million, but still recovered the amount in rates. SEC supported BOMA/LPMA's analysis.

AMPCO proposed a variance account to capture the reduced revenue requirements associated with under spending. BOMA/LPMA proposed a 5% (or approximately \$52 million) reduction in capital expenditures in each of the two test years. SEC argued for a 10% reduction and submitted that this would provide a "strong encouragement – at a relatively low cost – for Hydro One to improve its capital planning process for the future" BOMA/LPMA also noted that the Sustaining, Operations and Shared Services capital budget was above the Minimum Level of spending by approximately \$100 million. BOMA/LPMA argued that while it may not be prudent to reduce spending to the Minimum Level, it was appropriate to reduce it to a level that is at the mid-point between the proposed expenditure and the Minimum Level.

CME submitted that the Board should adopt an envelope approach to the issue and should determine an overall amount for each investment category.

CME also submitted that the Bruce to Milton project should be removed from the 2012 rate base. CME argued that it was overly optimistic to expect the project to be in service in 2012. BOMA/LPMA submitted that the evidence suggests that considerable risks remain that could prevent Hydro One from completing the project by 2012. BOMA/LPMA proposed that in light of the risks, Hydro One should establish a variance account to track the change in the 2012 revenue requirement if the Bruce to Milton project is not closed to rate base as currently projected. BOMA/LPMA argued that a variance account mechanism provided ratepayers with protection in case the project was delayed, while allowing Hydro One to recover the revenue requirement associated with the project if it is completed on time.

Hydro One responded that its capital expenditure forecast is based on a rigorous planning process that had adequately considered the effect on consumers' bills and the

need to invest in the transmission system. Hydro One submitted that its capital plan must be assessed based upon the evidence before the Board and that 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 further submitted that the evidence, combined with a lack of any specific criticism from intervenors and Board staff, demonstrates that the proposed capital expenditures are appropriate, and that they ought to be approved as requested.

## **Board Findings**

The Board accepts Hydro One's overall test year capital expenditure budget for 2011 and 2012. This approval pertains only to the expenditures related to non-Green Energy Plan projects. The appropriateness of capital expenditures related to Green Energy Plan projects are addressed separately in this decision.

As noted earlier, a portion of the test year capital expenditure budget is related to projects that will not be in service in the test years. These projects are classified as Category 3 and Category 4 projects. The majority of spending related to these projects is in Development Capital, with a few projects in the Sustaining Capital category<sup>4</sup>.

With respect to Category 3 projects, Hydro One sought guidance from the Board on the appropriateness of project need, the proposed solution, and the recoverability of the project cost. While the Board has approved the overall capital budget, it will not provide Hydro One with the guidance it has sought in relation to these projects. An advance ruling on the appropriateness of project need, proposed solution or the recoverability of project cost is premature at this time. In the Board's view the appropriateness of project need and prudence of costs are best considered when Board approval is sought to add these projects to rate base.

With respect to Category 4 projects, Hydro One did not seek approval for these projects in this application. The Company proposed to seek approval for these projects in future Section 92 applications. The purpose of including the spending on these projects in the capital budget was to inform the Board of the Company's future intent. The Board therefore believes that it does not need to address these projects in this application.

The remaining portion of the Development Capital budget is related to projects that will be in service in the test years. These projects were classified as Category 1 and Category 2 projects. In approving the overall capital budget, the Board approves the capital expenditures related to these projects.

The Board is not persuaded by the submissions of those parties that argued for a reduction to the capital budget based on an analysis of the historic spending levels

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<sup>4</sup> Board staff interrogatory 64

compared to the historic levels allowed for in rates. Nor is the Board persuaded that it is appropriate to reduce the spending to the Minimum level or close to it, as proposed by some intervenors.

While the Board accepts that a retrospective view of an applicant's activities is important and informative in the consideration of future spending, it has little value in isolation. This is a future test year application and historic activities must be considered in the context of the applicant's evidence supporting its projections of both future need and ability to execute its plan to meet those needs.

Hydro One has satisfied the Board that it has expended considerable effort and care in preparing its plans and organizing itself in an effort to improve its ability to execute its plan. In particular, its evidence pertaining to its outsourcing and human resource management is demonstrative of this effort.

In recognition of these initiatives the Board does not consider it necessary to further encourage Hydro One's demonstrated behaviour with notional reductions based on historic plan execution results. In the Board's view Hydro One has provided a reasonable capital spending plan that has sufficient evidentiary support to be used in its totality to derive its revenue requirement for the test years.

The Board's detailed findings and reasons for its non-acceptance of Hydro One's proposal to add its CWIP related to its Bruce to Milton project to rate base are found elsewhere in this decision. Given the Board's decision on this proposal it will address a disputed issue pertaining to rate base and the prospective timing of the completion of the Bruce to Milton project.

BOMA/LPMA submitted that due to the risks that remain that could prevent Hydro One from completing the Bruce to Milton project by 2012, Hydro One should establish a variance account to track the change in the 2012 revenue requirement if the project is not closed to rate base as currently projected. Hydro One did not respond to this particular BOMA/LPMA argument in its reply argument.

The Board accepts the BOMA/LPMA submission and directs Hydro One to establish a variance account for this purpose. As submitted by BOMA/LPMA, the variance account mechanism will provide ratepayers with protection in case the project is delayed, while allowing Hydro One to recover the revenue requirement associated with the project if it is completed on time.

This mechanism to ensure the alignment of the projected rate base with the matching revenues is not normally required by the Board. However, given the level of uncertainty of the project completion coupled with the quantum of the impact on the revenue requirement, the Board considers it appropriate in this case.

## **MATERIALS AND SUPPLIES INVENTORY**

Hydro One's materials and supplies inventory forecast for 2011 and 2012 is \$17.4 million and \$21.7 million. The materials and supplies inventory forecast is derived by averaging the previous year's year-end inventory and the current year-end inventory. Table 1 at Ex D1/T1/S4 provides the actual inventory levels for the period 2007 to 2010.

BOMA/LPMA argued for a reduction to the material and supplies inventory forecast, noting that the year over year increase in inventory was significant and that the increase had not been adequately justified. BOMA/LPMA noted that the projected increase in inventory was greater than the growth of assets in service.

BOMA/LPMA also questioned Hydro One's ability to accurately forecast inventory. BOMA/LPMA noted that in 2009 and 2010, actual inventory was \$11.7 million and \$12.7 million, whereas Hydro One's forecast was significantly higher at \$36.7 million and \$38.7 million respectively. According to BOMA/LPMA the test year inventory forecast should be reduced to \$15.8 million and \$17.5 million respectively.

Hydro One responded that effective January 1, 2008 it retrospectively adopted Canadian Institute of Chartered Accountants' (CICA) Handbook *Section 3031 - Inventories*, which required it to reclassify certain major spare parts and standby equipment that were previously classified as inventory as fixed assets. Hydro One explained that the Board approved materials and supplies inventory estimate for 2009 and 2010 was based on the old CICA standard, while the actual inventory for 2009 and 2010 reflects the adoption of the new standard. With respect to the increase in test year inventory levels, Hydro One noted that the increase was due to the growth in the transmission work program, specifically the Sustaining capital program.

### **Board Findings**

The Board accepts Hydro One's explanation of the drivers of the fluctuations in the recorded amounts in inventory and accepts that the increase is commensurate with the increase in the Sustaining capital program. The Board accepts Hydro One's forecast as adequate for calculation of this part of the revenue requirement.

## **RECOGNITION OF HST ON COMPONENTS OF RATE BASE**

The 8% Ontario provincial sales tax ("PST") and the 5% Federal goods and services tax ("GST") were harmonized effective July 1, 2010, at 13%. Now that the PST and GST are harmonized, Hydro One will pay the HST on purchased goods and services and is eligible to claim a full input tax credit on the PST portion paid. Therefore, Hydro One will no longer incur that portion of the tax that was formerly applied as PST.

Hydro One estimated the reduction in capital expenditures due to the elimination of the PST to be \$42.6 million in 2011 and \$35.8 million in 2012. The revenue requirement impact of these reductions is approximately \$4 million in each year. (When OM&A reductions are considered the impact on revenue requirement is approximately \$10 million). Hydro One revised its estimates in its final argument, as noted in the OM&A section of this decision.

BOMA/LPMA argued that the reductions in the test-year revenue requirement should be passed onto customers, especially in an environment where rates are rising significantly. BOMA/LPMA recommended the use of a variance account to capture any variances in the projected reductions in revenue requirement. BOMA/LPMA also noted that it was unclear from the evidence if the reductions in capital expenditures for the last six months of 2010 (i.e. post July 1, 2010) are reflected in the calculation of the test year rate base. BOMA/LPMA estimated the impact to be approximately \$1 to \$2 million in the test years.

BOMA/LPMA and VECC also noted that the effect of the introduction of the HST is to reduce the working capital amounts from \$7.1 million to \$0.8 million in 2011 and from \$5 million to \$3.4 million in 2012. These intervenors argued that the reductions in working capital should also flow through to customers.

In reply argument, Hydro One agreed to pass on the savings to customers by reducing the test year revenue requirement. Hydro One submitted that a variance account was not required.

## **Board Findings**

The Board accepts Hydro One's response that it will reflect cost reductions related to HST in its revenue requirement. The Board approved Hydro One's HST related adjustments in the previous section on OM&A. Hydro One shall recalculate the capital-related HST effect on revenue requirement in accordance with this decision.

## **ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION ("AFUDC")**

AFUDC is the interest rate used for construction work in progress. The AFUDC in 2011 is \$54.4 million and \$63.2 million in 2012. The AFUDC rate is 5.6% in 2011 and 6.1% in 2012.

BOMA/LPMA submitted that the AFUDC estimate of \$73.6 million in 2010, which is based on a rate of 4.9%, is over stated. BOMA/LPMA noted that the actual AFUDC rate in 2010 was 4.34%. Based on the revised rate, the AFUDC in 2010 is lower by \$6.4 million. BOMA/LPMA submitted that the reduction in the 2010 AFUDC should be reflected in the calculation of the test year rate base.

BOMA/LPMA also noted that the test year AFUDC is based on interest rate data from October 2008. In BOMA/LPMA interrogatory 28, Hydro One was asked to provide AFUDC estimates based on more recent economic data. The result is a reduction in test year AFUDC of \$3.2 million in 2011 and \$2.1 million in 2012. BOMA/LPMA submitted that Hydro One should reflect the reduced AFUDC in the calculation of the test year rate base.

### **Board Findings**

The Board considers the submissions of BOMA/LPMA to be reasonable and directs Hydro One to calculate its rate base for the test years using updated data.

## GREEN ENERGY PLAN

In a letter dated September 21, 2009, the Minister of Energy and Infrastructure instructed Hydro One to “immediately proceed with the planning, development and implementation” of certain transmission projects. The twenty major transmission projects in Schedule A of that letter and five enabling projects in Schedule B were developed by the Ontario Power Authority (“OPA”) and Hydro One to facilitate the connection of “renewable generation likely to be forthcoming through the feed-in tariff program.”

Hydro One’s Green Energy Plan (the “GE Plan”) is based entirely on the Minister’s September 2009 letter. That is, all projects and associated timelines identified in Schedule A and B of that letter are included in the GE Plan. The GE plan covers a ten year period from 2010 to 2020. The total gross cost of the GE Plan is \$7.7 billion, of which the cost of the Schedule A projects is \$6.9 billion and the cost of Schedule B projects is \$840 million.

Hydro One sought Board approval for the overall GE Plan and the capital expenditures of \$126.7 million in 2011 and \$198.1 million in 2012. Specifically, the capital expenditures are on two Schedule A projects and a number of Schedule B projects as set out in the Plan.

In addition to capital expenditures, Hydro One proposed to spend \$35.7 million in 2011 and \$46.7 million in 2012 on OM&A development work. The OM&A costs are in a deferral account and do not affect the test year revenue requirement.

The following issues are addressed in this chapter:

- GE Plan Approval
- Appropriateness of test year expenditures in the GE Plan
- Cost Responsibility

### GE PLAN APPROVAL

As noted, Hydro One’s GE Plan is based on the Minister’s September 2009 letter. On May 7, 2010, the Minister sent a letter to the OPA requiring new advice regarding transmission planning. Specifically, the Minister directed the OPA to “develop and submit an updated transmission expansion plan updating the September 2009 instruction to Hydro One”<sup>5</sup>. As a result of this letter, and pending updated instructions

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<sup>5</sup> Exhibit I/Tab1/Schedule 98/Attachment 1

from the Minister, Hydro One suspended work on all projects. At the oral hearing, Hydro One witnesses confirmed that new direction had not been provided.

In argument-in-chief, Hydro One submitted that it is not seeking Board approval for individual projects in the GE Plan, but is asking the Board to approve the GE Plan conceptually. Hydro One submitted that at a minimum, the Board should approve the capital expenditures on Schedule B projects. Hydro One further submitted that it intended to file an updated five year transmission Green Energy Plan in its next rate application.

Board staff submitted that the level of uncertainty around certain aspects of the GE Plan and the pending instructions from the Minister make it difficult to assess the appropriateness of the Plan, even at a conceptual level. Board staff submitted that the Board should wait for an updated Plan, as the company had indicated it was willing to provide as part of its next rate application. Notwithstanding the concerns with the appropriateness of the overall GE Plan, Board staff submitted that the Board could approve the GE Plan in part. In this respect, Board staff agreed with Hydro One that the Board should at a minimum consider approving those projects that are expected to go ahead in the test years.

CME submitted that the Board should refrain from approving the GE Plan on a conceptual basis. CME argued that the issue of GE Plan approval should be revisited after updated instructions are provided to Hydro One. Until that happens, CME submitted, the Board should confine its approval to those GE Plan projects that are ready for implementation.

BOMA/LPMA submitted that there was no value in approving the GE Plan on a conceptual basis and that the Board should defer approval until more information is available. BOMA/LPMA further submitted that the Board should confine its approval to the Schedule B projects proposed in this application.

CCC submitted that given that the Minister's September 2009 instruction on which the GE Plan is based is currently under review, it is difficult to assess the appropriateness of the Plan. CCC supported the investments on the three Short-Circuit upgrades, however noted that the Board's approval of these projects should not imply that the Board is approving part of the Plan.

AMPCO submitted that the Board should not approve the Plan and recommended that this aspect of the proceeding be kept open until such time that an updated plan can be filed. AMPCO also submitted that development work on all projects for which Hydro One receives cost approval and for which the Board invites licence transmitters to submit plans, should be made publicly available during the competitive bidding process.

Energy Probe and VECC submitted that it is not reasonable for the Board to approve the GE Plan conceptually and recommended the Board postpone the approval of the Plan until such time the OPA's advice is known and the impact of that advice assessed.

PWU submitted that it had no comment on the appropriate mechanism or terminology that the Board should use to address Hydro One's request for a "conceptual" approval of the GE Plan. PWU noted that whatever mechanism is pursued, the Board's decision should not prejudice the approval of future Green Energy projects.

Hydro One responded that the GE Plan as filed is conceptually appropriate in light of the objectives of the *Green Energy Act*. Hydro One submitted, "the plan at this time is "conceptual" because circumstances changed after it filed the Plan". Hydro One noted that the vast majority of the spending is beyond the test years and approval of the Plan in no way binds the Board with respect to future expenditures. Hydro One clarified that it is not seeking project specific approval, but rather approval of the overall Development capital budget.

## **Board Findings**

In the Board's view, for the purposes of its green energy plan approval role, the terms "conceptual" and "plan" are poor companions. The development of a plan, properly designated as such, involves a careful, detailed, blueprint-like process which has involved all of the necessary parties, taking into account all of the reasonably conceivable contingencies, and made provision for a small number of well researched and fully costed outcomes.

That is not to say that plans ought not to be somewhat flexible in order to deal with genuinely unanticipated circumstances. But the purpose of the plan, especially a plan directed to the transmission system, is to provide very detailed and thoroughly researched engineering guidance to its implementers. In the present case, to the extent that the Hydro One proposal is conceptual, it cannot qualify as a plan. There is no role for Board approval of conceptual plans.

In a letter to the industry dated October 27, 2010 the Board indicated its intention to develop a regulatory framework, informed by the Green Energy Act and other relevant considerations including total bill impact. In that letter the Board referenced the importance it places on the process involved in the development of plans. Specifically, the Board expressed interest in the development of a planning process that coordinated planning activities on a regional basis. The Board will be undertaking a consultation respecting its regulatory framework, and it is safe to say that matters of transparency, inclusiveness and coordination will be engaged in that consultation.

Apart from this consideration, the Board has concerns about approving in any degree projects that are not reasonably expected to be in service during the test year periods. There are two reasons for this reluctance.

First, the Board is concerned that its approvals not become a factor driving one program or project at the expense of another. The simple fact that the Board has approved a project could have the effect of advancing that project even though others may be more advisable.

Second, the Board is concerned that in this case its approval process ought to be directed to issues genuinely engaged within the test period. In the Board's view, decisions respecting these projects should be made within the context, and in light of all of the evidence presented by the Applicant in its cost of service review. There may well be exceptions driven by exigencies, and the Board can deal with those in due course. The Board's processes are flexible enough to enable it to be suitably responsive to emerging requirements. But it is inappropriate for a panel determining rates for 2011 and 2012 to be reaching very much beyond that time frame in its approvals. This is especially so in an environment which is so obviously dynamic. While the Minister's letter of September 2009 urged Hydro One to embark on an extremely challenging development process, the letter of May 7, 2010 to the OPA required an updated transmission plan that could significantly change the original instructions to Hydro One.

In this case, the development of and approval of a plan that reaches much beyond the test period would seem to be inadvisable.

It is clear that the pace at which significant system expansions and enhancements are to be undertaken is a matter of concern to all participants in the Ontario market at this time. This factor was also highlighted in the Board's letter of October 2010. In the Board's view, in the circumstances of this case, it is most appropriate for it to approve what comes before it genuinely connected to the test period, and not much more.

Accordingly, in the circumstances of this case, the Board will not approve the overall Green Energy Plan on a conceptual, or any other basis.

## APPROPRIATENESS OF TEST YEAR EXPENDITURES

The OM&A and Capital expenditures are summarized in the table below:

GREEN ENERGY PLAN SUMMARY OF OM&A AND CAPITAL EXPENDITURES (\$ Millions)				
	OM&A (Def A/c)		Capital	
	2011	2012	2011	2012
Schedule A Projects	\$ 35.7	\$ 46.7	\$ 4.5	\$ 22.6
Schedule B Projects			\$ 120.8	\$ 168.2

Projects less than \$ 3 million		\$ 1.4	\$ 7.3
<b>Total Expenditure</b>	<b>\$ 35.7</b>	<b>\$ 46.7</b>	<b>\$ 126.7</b>
<b>In-Service Capital Additions</b>		<b>\$ 11.4</b>	<b>\$ 198.9</b>
<b>Impact of Capital Additions on Revenue Requirement</b>		<b>\$ 0.9</b>	<b>\$ 10.3</b>

Hydro One sought Board approval for a test-year capital budget of \$126.7 million in 2011 and \$198.1 million in 2012. This includes spending on two Schedule A projects and a number of Schedule B projects.

The two Schedule A projects are the Sudbury to Algoma Project and the Northwest Transmission Project. These projects are not in the test year rate base and do not impact the test year revenue requirement. Hydro One submitted that it was not seeking project approval in this proceeding and will do so in a future Section 92 application. The reason for including the projects was to inform the Board of Hydro One's future intent.

The remaining amounts in the capital budget are for Schedule B projects. The projects in this category include:

- Short Circuit upgrades to Leaside TS, Hearn TS and Manby TS,
- Two Enabling TSs,
- One Static Var Compensator,
- Six In-line circuit breakers,
- Protection upgrades, and
- Transfer Trip facilities.

Not all schedule B projects will be in-service in the test years. Of the total capital expenditure that Hydro One sought approval for, only \$11.4 million and \$198.9 million will be added to the test-year rate base. The projects that will be in-service in the test year include the Short-Circuit upgrades to Leaside TS and Hearn TS, two In-line circuit breakers, Protection upgrades and Transfer Trip facilities. The Schedule B projects that will not be in-service in the test years are Short-Circuit upgrade to Manby TS, one Static Var Compensator, two Enabling TSs and four In-Line circuit breakers. Hydro One classified the latter category as "Category 3" investments. With respect to these investments Hydro One states, "it is seeking guidance from the Board on the appropriateness of need, proposed solution and recoverability of project cost".

In addition to capital expenditures, Hydro One proposed to spend \$35.7 million in 2011 and \$46.7 million in 2012 on OM&A development work. Hydro One did not seek approval for these costs in this proceeding. The OM&A costs are in a deferral account and do not affect the test year revenue requirement.

As noted earlier, on May 7, 2010, the Minister sent a letter to the OPA requiring new advice regarding transmission planning. As a result of this letter, and pending updated instructions from the Minister, Hydro One suspended work on all GE Plan projects.

Board staff submitted that the projects in the GE Plan are currently under review and there is no guarantee the two Schedule A projects (Sudbury to Algoma and the Northwest Transmission Expansion) will proceed. Accordingly, Board staff submitted that the costs should be removed from the test year capital budget. Notwithstanding the concerns noted with respect to cost responsibility which are discussed later in this Decision, Board staff supported the expenditures on projects that were forecast to be in service in the test years (i.e. Short-Circuit upgrades to Leaside TS and Hearn TS, two In-line circuit breakers, Protection upgrades and Transfer Trip facilities). With respect to the Schedule B projects that have capital spending in the test years, but will not be in-service in the test years (i.e. Short-Circuit upgrade to Manby TS, one Static Var Compensator, two Enabling TSs and four In-Line circuit breakers), staff noted that with the exception of the Short-Circuit upgrade to Manby TS, the need for the remaining projects had not been confirmed by the OPA. Board staff noted that the location of the two Enabling TSs and the four In-Line circuit breakers were not definitively known and submitted that the Board does not have sufficient information to provide the guidance that Hydro One has sought in relation to these projects.

AMPCO submitted that the capital costs of the two Schedule A projects should be removed from the capital budget. With respect to Schedule B projects that are expected to be in service in the test years, AMPCO supported the capital expenditure on the Short-Circuit upgrades and one In-line circuit breaker. AMPCO noted that Hydro One was able to definitively establish that only one in-line circuit breaker will be in service by 2012 and accordingly submitted that the cost of the second In-line circuit breaker should be removed from the test year rate base. With respect to Schedule B projects that will not be in service in the test years, AMPCO supported Board staff's position. With respect to OM&A costs, AMPCO submitted that Hydro One should not be allowed to undertake any spending on development work on Schedule A projects until such time that an updated GE Plan is filed.

BOMA/LPMA supported the capital expenditure on the three Short-Circuit upgrades. BOMA/LPMA noted that it was not appropriate to defer these projects given the short remaining life of the assets.

CME supported the spending on the Schedule B projects that are to be booked to the test year rate base, noting that the Board should consider approving those projects that are ripe for implementation.

CCC submitted that on a stand alone basis the Board should approve the capital expenditures related to the Short-Circuit upgrades. CCC however noted that the Board's approval of these projects should not be interpreted to mean that the Board is approving any part of the GE Plan. CCC also submitted that the request for the Schedule A

projects should be denied. Hydro One also sought approval to clear the 2009 balance of \$2 million in the OM&A deferral account. CCC argued that Hydro One had not justified this expenditure and the request should be denied.

PWU submitted that there was strong evidence and support for three Short-Circuit upgrades and argued that the Board reject any request that sought to defer the projects.

## **Board Findings**

With respect to the Schedule A projects, namely the Sudbury to Algoma and the Northwest transmission expansion projects, the Board notes that the Applicant is not seeking any form of approval with respect to these projects.

The Company is seeking approval for the Schedule B projects. The Board is prepared to approve the short-circuit upgrades to Leaside TS, the Hearn TS, the Manby TS, two of the in-line circuit breakers, protection upgrades and transfer trip facilities which have been specifically identified by the OPA. In the case of the Manby TS, the Board notes that it has already endorsed this project in a previous proceeding. These projects (with the exception of Manby) are also expected to be in service within the test year period. In the Board's view, the support for these projects, evidenced by the OPA's endorsement, and, in the case of the Manby TS the Board's own endorsement, together with the fact that they are generally intended to be in service within the time frame governed by this application, makes the Board's acknowledgment reasonable and appropriate.

The same cannot be said of the remaining schedule B projects. Not only would these projects not come into service within the relevant timeframe, but they have not been explicitly endorsed by the OPA. While endorsement by the OPA is not determinative, the Board considers it an important consideration in its assessment of such projects. In the Board's view, in the circumstances of this case, it would be inappropriate to provide the guidance the company seeks with respect to these projects.

It is important to note that the Board's decision to withhold project approval with respect to the remaining Schedule B projects does not inhibit the company from doing whatever it considers to be prudent in preparation for these projects. The primary implication of our failure to specifically acknowledge these projects is that company may need to bring the projects back to the Board for approval once more robust evidence of need is available.

Accordingly, the Board will not provide any guidance to the company with respect to the two enabling TS's, the static VAR compensator and four of the in-line circuit breakers represented in Schedule B.

## **COST RESPONSIBILITY**

### **Upgrade Short Circuit Capability Projects**

Included in Schedule B of the Green Energy Plan were three projects involving the upgrade of short circuit capability at the Hearn, Leaside and Manby transformer stations. No party argued that these projects were not needed, and several intervenors (for example BOMA/LPMA) submitted that the costs of these projects in the test years should be approved.

Board staff, in its questions to Hydro One and its submissions, raised the issue of cost responsibility for the advancement of the upgrade work at Leaside and Manby. The advancement costs are estimated by the OPA to be \$5.9 million for Leaside and \$4.9 million for Manby. Board staff argued that as the stations are classified as line connection assets, the Transmission System Code (“TSC”) would dictate a user pay approach for these advancement costs. This would mean that the advancement costs should not be collected from transmission ratepayers, but contributed by Toronto Hydro Electric System Limited (“THESL”), the transmission customer.

The Board notes that no party, in its final submissions, disagreed with Board staff’s interpretation of the TSC in regard to cost responsibility for line connection assets. The OPA supported Board staff’s interpretation. However, most parties who made detailed submissions on this issue recognized the potential unfairness of requiring a capital contribution from THESL.

Hydro One, THESL, the OPA and Pollution Probe argued that THESL and its customers are not the sole beneficiaries of the short circuit upgrades. Pollution Probe submitted that Hydro One’s proposal is in the best interests of all of Ontario’s (as well as Toronto’s) electricity consumers, as the encouragement of combined heat and power generation will reduce the need for costlier generation or transmission facilities. The cost of Hydro One’s short circuit upgrades should thus be paid for by all of Ontario’s electricity consumers. Hydro One and the OPA argued that the need for the work has been driven by the previous connection of generators to the system, and such connection benefits all Ontario electricity consumers.

The OPA further submitted that in the particular circumstances of this case, recovering the advancement costs from transmission ratepayers is consistent with the well-established rate-making principles of fairness, feasibility and non-discrimination, as well as the statutory objectives of the Board. The OPA recognized the difficulties in allocating costs to and recovering costs from the many and varied generators that may seek connection to THESL’s system. In addition, if the investments were undertaken at THESL-owned facilities, the Distribution System Code (“DSC”) might allow recovery by THESL from all provincial ratepayers of the costs of “eligible investments” to connect renewable generation. The fact that the transformer stations are owned by Hydro One

rather than THESL means that this source of recovery is not available, and the OPA submitted that this is arguably discriminatory treatment of generators based on location. To allow recovery from transmission ratepayers, the OPA argued, would be consistent with the Board's statutory objective to promote renewable energy generation.

Board staff also acknowledged as a potential problem that neither the DSC nor the TSC provides guidance on how THESL could recover the capital contribution from connecting generators. However, Board staff was concerned that to allow Hydro One to recover the costs from transmission ratepayers would set an unfortunate precedent. Staff pointed out that at present there is no economic connection test for investments in transmission connection facilities, and permitting recovery of such investments from transmission ratepayers moves the risk of uneconomic connections onto those ratepayers. Board staff urged that if the Board was to allow recovery of the advancement costs in transmission rates, that the Board make it clear that this is a response to a transitional issue, and not a policy for the future allocation of such costs.

The OPA echoed this concern, submitting that if the Board allows recovery of these costs from transmission ratepayers, it should do so in response to the particular issues of this case rather than set a policy precedent for future cost allocation. The OPA further proposed that the Board re-categorize a portion of the Leaside and Manby transformer stations as "network facilities" under the TSC.

THESL and other parties pointed out that there may be a gap in the existing policy framework. The OPA submitted that the issue of cost allocation for upgrades of short circuit capability would benefit from a focussed review led by the Board, and supported by the OPA, transmitters, and distributors. Hydro One supported the OPA's submission, and stated that it the company would fully participate in such a review.

## **Board Findings**

The Board accepts Hydro One's proposal to advance the upgrade work at Leaside and Manby and that the cost consequences of the advancement be included in its revenue requirement.

The Board notes that there has been no argument advanced attacking the merits of the proposed projects. The submissions all focus primarily on the responsibility for the costs to undertake these projects in advance of the projected end of the useful life of the assets. While the projects are included in the Applicant's Green Energy Plan, as the upgrades will allow for the connection of renewable generation, the advancement of the project is also driven in part by the anticipated scheduling difficulties that may arise if the work were to be left to coincide with the Pan Am games, to be held in Toronto in 2015.

It is clear to the Board that the particular circumstances that give rise to the cost responsibility issues in this application are not representative of the types of circumstances to which the prescribed cost responsibility allocation rules contained in the TSC are intended to apply.

The particular circumstances of this case were not precisely provided for in the TSC. The costs result from a relatively minor advancement which is driven by both the early facilitation of renewable sources of energy and prudent scheduling. For these reasons the Board considers it reasonable to apply a pragmatic approach to the cost recovery of the investment that does not result in any undue subsidies being paid by one set of rate payers to another. The Board considers Hydro One's proposal to meet this desired outcome.

The Board accepts the submissions of Board Staff and the OPA that should this decision be regarded as setting a precedent, there is a risk that the costs of uneconomic investment would be borne by transmission rate payers. The Board therefore wants to emphasize that this finding is a response to a particular transitional situation, and that this finding should not be regarded as an indication of appropriate regulatory treatment for future transmission investments.

### **Protection & Control for Enablement of Distribution Connected Generation**

Hydro One seeks to recover the costs of the Protection and Control ("P&C") projects D43 and D44 in transmission rates. Although the pre-filed evidence suggested that the work will be done on connection assets, Hydro One proposed that the costs be recovered from transmission ratepayers for two main reasons:

- The investments will have benefits to the entire system, and are not ultimately triggered by the needs of an identifiable customer or customers; and
- Attempting to allocate the costs to customers would be administratively complex and costly, and could act as a barrier to entry.

Board staff submitted that the Board should consider reducing the requested capital budget by \$10 million in 2011 and \$29.8 million in 2012 to recognize that the facilities in question are classified as connection facilities, and that the TSC prescribes a user-pay approach for such facilities.

Board staff acknowledged that these facilities may have benefits to the larger network system, but argued that where such equipment is installed at connection facilities, the rules in the TSC dictate a user-pay approach for all or part of the costs. Board staff submitted that while there may be complexities and potential unfairness involved in the application of the rules in the TSC and the DSC to the situations described by Hydro

One, the Board should have regard to the danger of the risks of uneconomic investments being passed through to transmission ratepayers.

Hydro One submitted in its reply argument that that it is not possible to identify at this time exactly how many network or connection stations will be affected. Hydro One further indicated that typically, system driven costs are pooled while costs that are customer driven are allocated to the customer. Hydro One stated that in customer driven cases, Hydro One follows the TSC for connection work and charges capital contributions accordingly.

Hydro One further submitted that P&C 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. While one generator might trigger the need for these investments at a particular station, the need is driven by existing and future generators, and the benefit extends to all these generators, as well as the load customers 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 the existing and future potential beneficiaries of the work and allocate costs accordingly. Hydro One provided examples of the integrated nature of the P&C investments to be carried out, and the complexity involved in Hydro One attempting to recover costs from distributors, and in the distributors in their turn attempting to recover costs from the connecting generators.

## **Board Findings**

The Board considers that there is not a compelling parallel between the treatment of the short circuit upgrades applied for in this case and the P&C work identified by the Company. Nor does the TSC recognize any such parallel.

One of the compelling arguments made by the Applicant and the OPA with respect to the rise of the short circuits at Leaside TS is that the increase in short circuits is attributable to all generators close to the station, and in particular the large Portland Generation project of about 550 MW which came into service in 2008. In that regard, one can agree that the strict application of the provisions of the TSC in regard to short circuits would result in an unfair and an unreasonable outcome.

On the other hand, P&C work is triggered and attributable to specific projects. The TSC is very clear that where the P&C work and equipment is installed on connection assets, the costs arising should be the cost responsibility of the entity requiring that the work be done. The P&C work, together with the equipment associated with it that is undertaken at Network Stations is assigned to the Network pool, and therefore there is no ambiguity as to how those costs should be allocated.

The Board considers that to deviate from this approach except in the clearest and most compelling case is unwarranted and could lead to gaming of the system, and the inappropriate “socialization” of costs which should be the responsibility of proponents. The TSC rules are intended in part to also curb uneconomic enhancements of the system.

As is known to the Applicant, requests for exemption from the provisions of the TSC can be made pursuant to the Board’s rules. In such an application the Applicant would be obliged to demonstrate why the application of the Code would be inappropriate in the specific circumstances cited.

The pre-filed evidence indicated that the amount of investment in the capital budget of \$10 million in 2011 and \$29.8 million in 2012 is for work in facilities classified as Transformation Connection. The Board therefore concludes that TSC prescribed user-pay approach for such facilities is appropriate. Consequently Hydro One’s capital budget and rate base should be adjusted to remove the amounts attributable to these projects, and a capital contribution be sought from the pertinent distributors.

## EARLY INCLUSION OF CWIP IN RATE BASE FOR THE BRUCE TO MILTON PROJECT

Hydro One, as part of its application, sought an accelerated cost recovery mechanism for the Bruce to Milton transmission line project. The company was granted leave to construct this project by the Board in 2008 (EB-2007-0050), and its relevance to the province's green energy policy was reinforced in a recent Ministerial directive to the OPA dated September 17, 2010. The project has been subject to delays and cost escalation. The planned in-service date is December 31, 2012, but Hydro One acknowledged that further delay was possible.

Hydro One previously sought special regulatory treatment for this project, but the proposal was rejected by the Board in EB-2006-0501. The Board did, however, indicate that Hydro One could bring the Bruce to Milton project, or other projects, forward for special treatment if circumstances arose putting the Applicant at risk. Subsequent to that decision, the Board considered the question of special regulatory treatment for infrastructure projects in a generic proceeding (EB-2009-0152), and released a Report entitled "*The Regulatory Treatment of Infrastructure Investment in Connection with the Rate-Regulated Activities of Distributors and Transmitters in Ontario*" on January 15, 2010 (the "Infrastructure Investment Report").

In the present application, Hydro One relied on the Board's Infrastructure Investment Report. The company proposed that one of the alternative mechanisms dealt with in the Infrastructure Investment Report: the inclusion in rate base of construction work in progress ("CWIP") costs (excluding depreciation) before the project is in service, be used as a rate mitigation and smoothing mechanism. Hydro One's evidence, as set out in Exhibit I-1-122, was that the total cost to ratepayers over the life of the project would be lower by \$68 million under the early CWIP recovery approach than under traditional regulatory treatment (by which all costs of the project are recovered subsequent to the in-service date).

The main reason put forward by the Company for the proposal was that this CWIP treatment would benefit ratepayers. It did not appear from the evidence that Hydro One was experiencing cash flow problems that would render exceptional treatment necessary.

Board staff and several intervenors analyzed Hydro One's proposal using the factors enumerated at page 21 of the Board's Infrastructure Investment Report. The need for the project was not disputed by any party. Several parties argued that only unusual risks or particular challenges would justify the use of an alternative mechanism, and that the risks cited by Hydro One for this project were common to most transmission projects in Ontario, which are by their nature subject to unanticipated difficulties and delays. Hydro One, in its reply, argued that the Board's Infrastructure Investment Report does

not require a project to have “unique” risks, but rather risks in general associated with project completion.

No ratepayer intervenor accepted the Company’s argument that the proposal would benefit ratepayers. Several intervenors (BOMA/LPMA, SEC and AMPCO) tested the sensitivity of the company’s NPV calculations to the discount rate used in the calculation. Exhibit J6.9 demonstrated that the calculated benefit to ratepayers disappears if a discount rate at or above 7.81% is used. These intervenors argued that the cost of capital for Hydro One’s customers is at least 7.81%, and that the early recovery of CWIP costs would actually be a disbenefit to ratepayers.

Hydro One replied to these arguments, pointing out that the company, in its calculations of the NPV of the project, had used the after-tax discount rate based on Hydro One’s cost of capital, a methodology that has been accepted by the Board, and is commonly used for economic evaluations in Section 92 applications when assessing overall project economics and rate impacts. Hydro One did not agree that a proxy for the consumer’s cost of capital should be used, but argued that if a proxy is to be used, then the OPA’s social discount rate is the best proxy. This discount rate is approximately 4%.

## **Board Findings**

In its Infrastructure Investment Report, the Board outlined a series of measures which it would consider on a case-by-case basis to assist regulated utilities in meeting their obligations. In large part that Infrastructure Investment Report was predicated on the view that both distributors and transmitters may be faced with extraordinary infrastructure building requirements as a result of the Government’s green energy policy. There was and is a concern that in meeting the government’s aggressive requirements under the *Green Energy Act*, utilities could be put at risk unless they had confidence, and the general business community had confidence, that they could complete requisite projects without undue risk of failed or dangerously slow cost recovery associated with these projects.

In the Infrastructure Investment Report, the Board was mindful that in some circumstances, the underlying reliability or safety of supply which characterizes the Ontario electricity distribution and transmission systems could conceivably be compromised if utility resources were overburdened or stretched too thin in meeting infrastructure expansion requirements.

A number of measures were identified, including accelerated CWIP recovery, adjusting depreciation, and project-specific capital structure or rates of return. The Board also indicated that if other measures addressing the same issues were to be proposed by transmitters or distributors, the Board would give them due consideration.

In the instant case, Hydro One proposes that the acceleration of CWIP inclusion in rate base would provide a benefit to ratepayers. Its submission is that including costs related to construction associated with the Bruce to Milton project into rate base as they are incurred, rather than at the time they are placed in service, lowers the overall cost of the project to ratepayers, and would also serve as a rate smoothing and mitigation mechanism.

First, the Board would note that the Infrastructure Investment Report on alternative treatments for costs incurred in infrastructure development did not direct itself to issues related to rate reduction, mitigation or smoothing. The Board takes it as a given that where alternative methods may be used which are likely to result in lower rates, the utility has an obligation to explore, and where reasonable, advance such alternatives. The purpose of the Infrastructure Investment Report was to assist utilities in meeting their obligations in a period during which their resources may become unreasonably stretched.

It is clear from the evidence in this case that Hydro One is not experiencing cash flow or other financial difficulties in meeting its infrastructure obligations, including the very demanding project for which alternate recovery is being sought. There was no suggestion in the evidence that the Applicant's ability to meet the prevailing reliability and safety expectations of its customers was in any degree compromised by its Bruce to Milton construction project.

Further, the Board notes that the Company is completely and unalterably committed to the completion of this project. This is not a case where a utility, in looking forward to a proposed project, submits that completion of the project would compromise its financial integrity. In such cases it is reasonable for utilities to argue for alternate treatment of their expenditures as a species of inducement to encourage, indeed in some cases make possible, completion. Here, the Company is fully committed to the project, on the terms and conditions underpinning the Board's approval of the project, and is not advancing any assertion that the project has become an unsustainable burden.

As the Board considers the rate reduction argument made by the Company, we must consider its net present value calculation for the project. The Company has indicated that it has used its own cost of capital in assessing the relative value of advancing the inclusion of construction costs into rate base. In conducting the economic evaluations required for construction projects it has become usual to use the proponent's cost of capital as an input. This approach is indeed appropriate in the normal course of economic evaluations. But in this case intervenors argued that a different objective is being served, namely the calculation of the ratepayer benefit associated with the Company's proposal. A consideration of the ratepayer benefit necessarily requires a consideration of the appropriate cost of capital/opportunity cost to be applied. The Company has suggested first that using its cost of capital for the evaluation should be determinative, and, in the alternative that the OPA's social discount rate should be used.

Both of these proposals were strongly resisted by a number of intervenors.

It is the Board's view that the appropriate approach to be used in this comparison is to consider a comparison that is based on a proxy for the opportunity cost of money experienced by the typical ratepayer. That number is difficult to determine, but could very well exceed 7.8%, at which point the argued-for advantage to customers disappears.

As to the consequential mitigation and rate smoothing, the Board is not convinced that these effects are likely to be particularly meaningful to Hydro One's transmission customers. Mitigation and rate smoothing are complicated concepts. Generally, it is important that ratepayers not be confronted with increases that are of such a magnitude that they create undue hardship. It is also true that volatile rates are very unwelcome to consumers. However, it is also important that consumers have a very clear picture about the cost of the services that are being provided to them, the origins of those costs, and the fact that sooner or later all of these costs will be borne by ratepayers. While mitigation and rate smoothing can be useful regulatory instruments, they ought not to be overused to the extent that consumers fail to appreciate the direct and unavoidable consequences of utility activities, including infrastructure expansion.

Furthermore, the evidence has shown that the Company's proposal to include CWIP in rate base will result in higher rates for the first 12 years of recovery of the project costs. The Board is not persuaded that regardless of the discount rate used, an alternate approach which results in higher rates to customers until 2024 should be adopted in the present environment.

Accordingly, the Board denies the Company's request for the accelerated inclusion of CWIP into rate base with respect to the Bruce to Milton project.

BOMA/LPMA made two further suggestions in its argument. First, that the Board should consider using the actual CWIP rates to calculate the amount of AFUDC to go into rate base in the test years, with a variance account to track the impact of the project on rate base in 2012. Secondly, BOMA /LPMA suggested an alternative approach that would allow the company to expense AFUDC during the test years rather than capitalizing these amounts. BOMA/LPMA emphasized, however, that the Company should be allowed to expense AFUDC only if the Board found that the standard regulatory treatment of allowing capitalized costs into rate base upon plant coming into service was inadequate for the Bruce to Milton project. The Board finds that the standard regulatory treatment is adequate in the circumstances of this application.

## CAPITAL STRUCTURE AND COST OF CAPITAL

The table below summarizes the capital structure and cost of capital for the two test years in Hydro One's original application.

Deemed	2011				2012			
	\$M	%	Cost Rate (%)	Return (\$M)	\$M	%	Cost Rate (%)	Return (\$M)
Long-term Debt	\$4,692.0	56.0%	5.67%	\$265.9	\$5,115.3	56.0%	5.64%	\$288.3
Short-term Debt	\$ 335.1	4.0%	3.99%	\$13.4	\$365.4	4.0%	5.00%	\$ 18.3
Common Equity	\$3,351.4	40%	10.16%	\$ 340.5	\$ 3,653.8	40.0%	10.41%	\$380.4
<b>Total</b>	<b>\$ 8,378.5</b>	<b>100.0%</b>	<b>7.40%</b>	<b>\$ 619.7</b>	<b>\$ 9,134.6</b>	<b>100.0%</b>	<b>7.52%</b>	<b>\$ 687.0</b>

Hydro One has filed its capital structure and cost of capital in a manner that was consistent with the Board's December 11, 2009 Report on the Cost of Capital for Ontario's Regulated Utilities (EB-2009-0084) ("the Cost of Capital Report").

### Short-Term Debt

Hydro One's deemed amount of short-term debt is 4% of rate base. The methodology reflected in the Cost of Capital Report provides that the short term rate is calculated as the average Bankers' Acceptance for the 3 months in advance of the effective date for the rates, plus the average calculated spread.

Variable rate debt, which pays interest based on the bankers' acceptance rate, has been included as part of the deemed short term debt amount of 4%. For Hydro One Transmission the deemed short-term rate is 3.99% for 2011 and 5.00% for 2012. These rates are calculated using the November 2009 Global Insight Forecast plus a spread of 150 bps, which is an estimate of the spread that would be charged to Hydro One to obtain a short-term loan in the bank market.

Hydro One assumes that the deemed short term debt rate for each test year will be updated in accordance with the December 11, 2009 Cost of Capital Report, upon the final decision in this case.

## Long-Term Debt

Hydro One's long term debt rate (56% of rate base) is calculated as the weighted average rate on embedded debt, new debt and forecast debt planned to be issued in 2010, 2011 and 2012.

As Hydro One has a market-determined cost of debt, the weighted average long term debt rate is also applied to any notional debt that is required to match the actual amount of long term debt to the deemed amount of long term debt, consistent with the Board's Decision in EB-2008-0272.

## Return on Equity

The Return on Equity of 10.16% for the 2011 test year and 10.41% for the 2012 test year is based on the Board's formulaic approach adopted in the Cost of Capital Report, using the Long Canada Bond Forecast for 2011 and 2012, based on the September Consensus Forecast and Bank of Canada data which was available in October 2009, and the change in the spread of A-rated Utility Bond Yield. Hydro One assumes that the return on equity for each test year will be updated in accordance with the Cost of Capital Report, upon the final decision in this case.

Board staff, VECC and BOMA/LPMA made submissions on long term cost of debt. SEC supported the BOMA/LPMA position.

Board staff, drawing on evidence updates presented in the case through interrogatory responses, submitted that Hydro One should update its long term debt costs for the new debt it has issued since its original application. Board staff indicated that this is in compliance with the EB-2009-0084 Cost of Capital Report. BOMA/LPMA also submitted that the long term debt rates be updated for actual issuances of debt. BOMA/LPMA cited the reductions in 2011 long term debt costs of \$2.3 million and 2012 reductions of \$4.1 million, agreed to as reasonable by Hydro One's witness Mr. Struthers.

In addition, BOMA/LPMA submitted that Hydro One should update its forecast of long term debt using the most recent information available, rather than the forecasts compiled using October and November 2009 data. BOMA/LPMA argued that if other rates are updated based on September 2010 information, then long term rates should be updated on the same basis.

VECC supported the arguments of Board staff and BOMA/LPMA and argued specifically that the Board should reduce the allowed medium-long term embedded weighted average debt costs for 2011 and 2012 by \$2.3 million and \$4.1 million, respectively.

In its reply argument, Hydro One agreed to update its evidence for the actual 2010 debt issues in the final rate order for 2011 rates. In addition when 2012 rates are established in late 2012, Hydro One would update long term debt for with actual 2011 issues.

### **Board Findings**

As a general rule the Board prefers that all rate decisions are informed by the most recent relevant data possible. This case is no different, and it appears that among the parties, including the Applicant, there was a realization that updating portions of the data used in the calculation of the cost of capital was desirable. Accordingly, the Board expects Hydro One to update its cost of capital for ROE and Short Term Debt based on the parameters issued by the Board on November 15, 2010. In addition, the Board also expects Hydro One to make a similar update for its 2012 transmission revenue requirement and rates in the fall of 2011.

In addition, the Board also considers it to be generally desirable to incorporate actual values when they can be used in place of estimates or forecasts.

On the specific issue of long term debt forecasts, the Board relies on the Cost of Capital Report and finds that Hydro One should update its long term debt forecasts to reflect and take account of actual issuances of debt since the time of the original application. These revised forecasts should be used for setting rates in 2011 and in 2012.

The Board is also persuaded by the BOMA/LPMA submission respecting the desirability of consistent updating of all debt forecasts. Accordingly the Board directs Hydro One to update its forecast of long term debt with the most current information, which is September 2010 data. Similarly, when Hydro One updates interest rates in the fall of 2011 for 2012 rates, the forecast of long term debt should also be updated for September 2011 data.

## FORECAST OF OTHER REVENUES

Hydro One receives additional revenue from a number of sources which work to offset the transmission rates revenue requirement. For the test years, these other sources of revenues are summarized in the table below:

**Transmission Other Revenues Forecast  
2011 and 2012**

	<b>2009 (\$ million)</b>	<b>2010 (\$ million)</b>	<b>2011 (\$ million)</b>	<b>2012 (\$ million)</b>
<b>Secondary Land Use</b>	14.2	11.3	12.6	12.5
<b>Station Maintenance</b>	14.6	2.9	4.6	3.0
<b>Engineering &amp; Construction</b>	3.2	1.5	11.0	6.0
<b>Other</b>	3.2	2.3	3.2	3.2
<b>Total</b>	35.2	18.0	31.3	24.7

Source: Exhibit E1/Tab1/Schedule 2

Related to the external revenue forecast, Hydro One also proposed to discontinue the variance accounts established in the last transmission rates case (EB-2008-0272) for Secondary Land Use, Station Maintenance and Engineering & Construction.

VECC included a number of detailed comments on the external revenue categories. For Secondary Land Use, VECC noted that the forecast revenues for 2011 and 2012 were in line with the current forecast for 2010 (\$12.5 million) but less than the actual 2009 revenues of \$14.2 million. VECC also noted that the forecast does not include any allowance for one-time events, which sometimes do occur and can only serve to increase revenues. BOMA/LPMA also supported the continuance of the variance account, citing that Hydro One had not demonstrated that it is able to accurately forecast these amounts.

SEC submitted that the forecast for 2007 should be increased to \$17.2 million to reflect the last three years of actual results and also supported the continuance of the variance account.

In the case of Station Maintenance, VECC noted that forecast revenues are much lower than actual revenues for 2009 and 2010, mentioning also that Hydro One attributed the

decrease to an expected shift in resources to its own work programs. VECC pointed out that Hydro One had a similar rationale in EB-2005-0501 and in EB-2008-0272 and, in both cases, actual revenues were higher than forecast.

VECC submitted that the forecast for Station Maintenance work be rejected by the Board and a forecast based on the historic three year average of \$13.4 million be used for 2011 and 2012. This would reduce the Transmission revenue requirement for 2011 and 2012 by \$8.6 million and \$10.4 million respectively.

VECC pointed out that in the EB-2008-0272 Decision, the Board recognized the uncertainty associated with forecasting revenue in these areas and the one-time events that can increase revenues. In order to ensure that ratepayers receive the benefit of these revenues, the Board established variance accounts. VECC argued that the circumstances had not changed and submitted that Hydro One should be directed to maintain variance accounts for each of these activities.

BOMA/LPMA also supported the continuance of the Station Maintenance and Engineering and Construction accounts indicating that Hydro One is still unable to accurately forecast the revenues, costs and resulting margins associated with these activities. SEC also supported the variance account continuance and that the forecast drop in revenues is unsupported by the evidence.

Board staff and CCC also submitted that these variance accounts be continued until the variances are sufficiently immaterial.

Hydro One, in its reply argument, indicated that it felt that the forecasts for each of these activities were appropriate but also acknowledged the concerns voiced by intervenors and indicated that Hydro One is agreeable to the continuation of these three accounts.

### **Board Findings**

The Board is concerned with the accuracy of the forecasts of other revenue and notes Hydro One's agreement to continue the variance accounts. The variance accounts shall remain in place until Hydro One can demonstrate improved accuracy in the forecasting of these amounts.

As for the forecast amounts themselves for the two test years, the Board finds that in light of the under-forecasting that has occurred in the Station Maintenance account, that Hydro One should revise its forecast for this account. However, the Board is of the view that the VECC recommendation (average of historic three years) is too high considering the fact that Hydro One is moving to reduce this work. The Board finds that the forecast for Station Maintenance be increased to \$7 million for each of the test years.

## FORECAST OF EXPORT REVENUES

The Board notes that the level of Export Revenue is directly dependent on the Export Transmission Services (ETS) rate decision found later in this document.

For this application, Hydro One assumed that the existing ETS rate of \$1/MWh was in effect for the purpose of determining the Revenue Requirement and associated rates for Network Service for 2011 and 2012. For 2011 and 2012, ETS revenue will continue to reduce to the revenue requirement for the Network Pool. The forecast for ETS revenue is \$10.1 million and \$10.2 million per year for 2011 and 2012, respectively.

Hydro One also requested that the variance account related to export revenue be discontinued for 2011 and 2012 as it asserted that it had sufficient history to allow for a more accurate forecast of this stream of revenue.

VECC submitted that the evidence showed that the variance between forecast export revenues and actual revenues is still significant and recommended that this variance account be continued. VECC also noted that continuation of the variance account will also address any increased revenue uncertainty that may arise should the Board decide to adopt an ETS tariff for 2011 and/or 2012 that differs from the \$1/MWh. CME supported these submissions.

BOMA/LPMA noted that the forecast of export revenue was shown to be consistently low over the 2007 to 2010 period. Based on this, BOMA/LPMA submitted that the Board should increase the export revenue forecast for both 2011 and 2012 to \$14.0 million. This is the average of the actual export revenue for 2005 through 2009, but excluding the \$24.6 million recorded in 2008, resulting in an increase in export revenues of \$3.9 million in 2011 and \$3.8 million in 2012 from that forecast by Hydro One. These increases are roughly in line with the 36% under forecasting average for the 2005 through 2009 period. BOMA/LPMA also recommended that the variance account be continued, given Hydro One's 'terrible' record of forecasting export revenues.

BOMA/LPMA also recommended that the variance account be used to account for any change in export revenues that could arise from a change in the ETS rate.

SEC did not make a specific submission on the level of Export Revenues but did recommend an increase in the ETS tariff to at least \$3.00/MWh by January 1, 2011. This would increase the export revenue that would offset transmission rates. CCC submitted that the variance account be continued, arguing that Hydro One did not present sufficient evidence to eliminate this account.

In its reply argument, Hydro One did not comment on the level of Export Transmission revenue, but did not oppose continuing the Export Revenue variance account.

## **Board Findings**

The issue of export revenues is directly dependent on the findings of the Board on the ETS rate. As indicated in the Export Transmission rate section of this decision, the Board has determined that the ETS rate will be \$2/MWh for both 2011 and 2012. Therefore, the Board instructs Hydro One to amend the estimate of export revenues to \$16 million for both years. The Board will also order that the variance account be maintained to address the forecast uncertainty of these revenues.

## DEFERRAL AND VARIANCE ACCOUNTS

### Disposition Balances and Disposition Period

Hydro One requested the disposition of the December 31, 2009 credit balance of \$7.4 million including interest forecasted to December 31, 2010. Three of the five accounts had credit balances, and two accounts had debit balances as of December 31, 2009. Hydro One proposed to dispose of a total of \$12.5 million of the credit balance over one year to mitigate the impact of the requested rate increase in 2011; and \$5.1 million of the debit balance over two years.

### Deferral/Variance Accounts Balances as of December 31

Account Description	Account Number	Balance Dec. 31/09 \$Million	Balance Dec. 31/10 \$Million
Export Service Credit Revenue	2405	(4.8)	(4.9)
External Secondary Land Use Revenue	2405	(3.2)	(3.2)
External Station Maintenance and E&CS Revenue	2405	(4.4)	(4.4)
<b>Subtotal proposed for disposition over 1 year</b>		<b>(12.4)</b>	<b>(12.5)</b>
IPSP & Other LT Project Planning Costs	1508	1.9	2.0
Pension Cost Differential	2405	3.1	3.1
<b>Subtotal proposed for disposition over 2 years</b>		<b>5.0</b>	<b>5.1</b>
<b>Total Balance proposed for disposition</b>		<b>(7.4)</b>	<b>(7.4)</b>

There was no challenge to the amounts recorded in any other accounts, except for IPSP & Other LT Project Planning Costs account.

CCC submitted that the recovery of IPSP account balance should be denied as there is no evidence that the funds were prudently spent. Hydro One in its reply submission submitted that this account was created pursuant to the Board's decision in EB-2008-0272 to record preliminary planning costs for IPSP and other long term projects, and that Hydro One's pre-filed evidence explained the amounts recorded in the account on a project by project basis.

Hydro One pointed out that it was directed by the Minister in a letter dated September 21, 2009 to “immediately proceed with the planning, development and implementation of Transmission Projects outlined in the attached Schedule A.” In addition, the Board in its decision EB-2008-0272 noted that: “An important consideration in this specific request is that Hydro One’s activities are clearly driven by current Ontario energy policy. Hydro One itself is not the driver behind these expenditures; as the largest transmission utility in the Province, it is responding to the policy drive by the Ontario government to meet certain objectives regarding new generation. Although project plans have not unfolded as originally conceived, there are clear expectations of the largest transmission utility that the planning work for these projects must continue.”

## **Board Findings**

The Board finds that the disposition of the IPSP and Other LT Project Planning Costs account is justified.

In the Board’s view it would be a harsh outcome to deny recovery of these development costs. It is clear that the company was responding in a reasonable fashion to the instructions it had received from the Minister in September, 2009. The Board is confident that the company undertook these expenditures with a high degree of confidence that the instructions provided by the Minister, in this case in his capacity as shareholder, would be enduring and would form part of an ongoing execution of government policy. That the instructions changed some months later was not the fault of the utility.

In future, the Board may be less willing to recognize expenses incurred in response to the shareholder’s direction, when that direction is given in that capacity. Going forward, such instructions need to be seen as a communication between the shareholder and the company’s management, and not necessarily as clear, actionable directions from the Minister in his or her capacity as Minister. Directives issuing from the Minister as Minister should be seen as non-discretionary in a way that instructions from the Minister as shareholder are not. In the one case, where the Minister issues a directive as Minister, recovery of costs should be the generally expected outcome, provided the spending was incurred prudently. In the other case, a more detailed and searching rationale may be needed to support recovery of costs through rates. In this context, this utility ought not to be treated any differently than any other utility receiving instructions from its shareholders.

Hydro One has proposed to return to its customers a net amount of \$7.4 million arising from the disposition of all of the accounts. An amount of \$12.5 million is proposed to be returned over 12 months, and \$5.1 million is proposed to be collected over 24 months. On a net basis, Hydro One has proposed to rebate approximately \$10 million to its customers in 2011, and collect \$2.6 million from its customers in 2012. The reason for this proposed pattern of disposition is stated to be to provide maximum rate mitigation in 2011.

BOMA/LPMA and VECC are opposed to the 24 month disposition period for the balances to be collected from customers. Both intervenors submitted that Hydro One should return the net amount of \$7.4 million over a 12 month period in 2011. This approach would provide rate mitigation in 2011, when the rate increase is larger.

The Board agrees with the intervenors, and finds it preferable to dispose of the balances in these accounts over a 12-month period in 2011 rather than return a larger amount to customers in 2011, only to recover some portion of it in 2012.

## Proposed New Accounts and Continuation of Accounts

Hydro One requested approval to continue or establish new deferral accounts for the following costs:

1. Impact for Changes in IFRS Account (2012 only)
2. IFRS – Gains and Losses Account (2012 only)
3. IFRS Incremental Transition Costs Account
4. Pension Cost Differential Account
5. Long-term Project Development OM&A Account
6. Tax Rate Changes Account
7. OEB Cost Differential Account

## IFRS Related Accounts

The new variance account proposed for Impact for Changes in IFRS for 2012 is for recording the aggregate impact on the 2012 revenue requirement resulting from any changes to existing IFRS standards or changes in the interpretation of such standards from what was in place at the date of Hydro One's application. CCC and BOMA/LPMA accepted the establishment of this account, as did Board staff. SEC recommended that the Board deny approval to establish the new deferral and variance accounts proposed by the Applicant.

Hydro One pointed out that an identical account was approved by the Board in Hydro One's recent distribution rate case, EB-2009-0096.

Hydro One proposed to establish IFRS – Gains and Losses Account for 2012 to record gains and losses on asset sales and losses resulting from premature asset retirements. The recorded amounts would be subject to Board review prior to disposition. SEC was not in favour of establishing this account. CCC and VECC, and Board staff had no objection to the establishment of this account. However, 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 premature retirement of an asset. Hydro One, in its reply submission, 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.

## **Board Findings**

The Board accepts Hydro One's proposal and approves the establishment of the two new IFRS related accounts - Impact for Changes in IFRS Account; and IFRS – Gains and Losses Account.

The Impact for Changes in IFRS Account is approved to record the impact on revenue requirement of changes in IFRS arising between those IFRS standards in force at the date of the company's application and those in force at the time of their next application, i.e. IFRS to IFRS changes. The Board considers it reasonable that Hydro One be allowed to record the effects from changes that might arise under IFRS after the date of their application for consideration in a future proceeding. This account is not for use in recording differences between Canadian generally accepted accounting principles and IFRS.

IFRS – Gains and Losses Account is approved as proposed by Hydro One, including the depreciation credit suggested by VECC.

The Board also approves the continuation of the IFRS Incremental Transition Costs Account proposed by Hydro One. No party objected to Hydro One's request to continue this account. It had been authorized previously in EB-2009-0096 by the Board.

## **OEB Cost Differential Account**

With respect to OEB Cost Differential Account, Board staff submitted that this account was originally created for electricity distributors through Article 220 of the Accounting Procedures Handbook as follows:

“This account shall be used to record the difference between OEB costs assessments invoiced to the distributor for the Board's 2004/05 and 2005/06 (up to April 30, 2006) fiscal years and OEB costs assessments previously included in the distributor's rates.”

The account was closed to new principal entries after April 30, 2006 as the distributors' revenue requirements included amounts for Board cost assessments beginning in 2006.

The evidence on the record<sup>6</sup> indicates that Hydro One's revenue requirement also includes an amount for OEB cost assessments. Intervenors CMA, CCC, SEC, and VECC made submissions against granting this account to Hydro One.

Hydro One, in its reply submission, stated that its request to continue to track the differential between forecast and actual annual OEB cost assessment 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, and a similar account was approved by the Board in Hydro One's last distribution rate proceeding.

### **Board Findings**

The Board finds that Hydro One is not justified in continuing to use this account, since its revenue requirement already includes an amount for OEB cost assessments. The original purpose of the account was to assist utilities that were unable to include a forecast of the Board's increased assessed costs in their rate applications because they arose in years for which rates were already set, not as an ongoing variance account. Accordingly the OEB Cost Differential Account should be closed.

### **Other accounts**

There was no opposition to the continuation of the Pension Cost Differential Account, the Long-term Project Development OM&A Account, and the Tax Rate Changes Account. The Board approves continuation of these accounts.

### **Proposed Discontinuance of Accounts**

Hydro One, in its pre-filed evidence, asked to discontinue the following 3 variance accounts:

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

CME, CCC, BOMA/LPMA & AMPCO, SEC, and VECC, all argued against Hydro One's proposal to discontinue the use of Export Service Credit Revenue, External Secondary Land Use Revenue and External Station Maintenance and E&CS Revenue variance accounts, as did Board staff.

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<sup>6</sup> Exhibit C1/Tab2/Schedule 7, page 18

Board staff submitted that Hydro One had a total credit of \$12.5 million in these accounts as of December 31, 2009, and submits that it would be premature to discontinue the use of these accounts at this time until it is proven that the variances are sufficiently immaterial to cease tracking them in the variance accounts.

Hydro One, in its reply submission, stated that it is agreeable that the Board approve continuation of these three external revenue accounts.

### **Board Findings**

The Board approves the continuation of the Export Service Credit Revenue, External Secondary Land Use Revenue and External Station Maintenance and E&CS Revenue variance accounts for the test years.

### **International Financial Reporting Standards (IFRS)**

Hydro One used Canadian Generally Accepted Accounting Principles (CGAAP) for the 2011 filing. This is consistent with the July 28, 2009 *Report of the Board on Transition to IFRS* (EB-2008-0408) (“Board IFRS Report”). For 2012, Hydro One filed its submission as a Modified IFRS (MIFRS) submission, using the assumption that MIFRS equals CGAAP, with two significant exceptions, which Hydro One has asked the Board to approve. These exceptions are:

- That Hydro One be allowed to continue to capitalize, for regulatory purposes, overhead expenditures such as training, Common Corporate Functions and Services (“CCF&S”) and Line supervision which would not be capitalized using IFRS but which Hydro One states are causally associated with the construction and bringing into service of new capital works; and
- That Hydro One be permitted to establish a new variance account to record gains and losses on tangible and intangible asset sales or losses which result from premature retirements.

Elsewhere in this Decision, the Board has directed the establishment of the variance account IFRS – Gains and Losses Account.

Hydro One wishes to continue to capitalize overhead expenditures associated with the construction and bringing into service of new capital works such as training, CCF&S and line supervision that would not otherwise be capitalized under IFRS. The specific proposal is for such costs to be capitalized for regulatory purposes as a continuation of existing practices.

The Board IFRS Report addressed the topic of accounting for overhead costs in the cost of new capital work effective January 1, 2011 in Issue 3.3. The report stated the following:

“3.3 The Board will require utilities to adhere to IFRS capitalization accounting requirements for rate making and regulatory reporting purposes after the date of adoption of IFRS... Revenue requirement impacts of any change in capitalization policy must be specifically and separately quantified.”

The Board issued a letter on February 24, 2010, clarifying and reinforcing the capitalization policy stated in the Board IFRS Report. The letter states:

“This letter is to clarify that the Board’s position on Issue 3.3 from the Board IFRS Report applies independently of what the approval outcome of the IASB draft standard may be, as follows:

- As stated in the Board IFRS Report at Issue 3.3, the Board is requiring full compliance with IFRS requirements (e.g. IAS16) as applicable to non-regulated enterprises and only where the Board authorizes specific alternative treatment for regulatory purposes is alternative treatment acceptable.

Section 7 of the Board IFRS Report states that all rate impacts should be considered in aggregate, and then any mitigation mechanisms should be addressed, if required.

“7.2 Rate impacts should be considered in aggregate to determine the significance of the cumulative effect. [Distributors] must provide specific information regarding the individual cost drivers making up the aggregate impact.

7.3 Utilities must provide a proposal for a rate mitigation mechanism if the impact is material and mitigation appears to be required.”

Hydro One did not provide a response to the interrogatory question regarding rate impact mitigation actions.

Hydro One, in its reply submission, discussed the following options for the Board to consider:

- To reflect the increased revenue requirement of \$200M in rates beginning when it adopts MIFRS in 2012,

- Approve Hydro One's requested costing exception,
- Use a deferral account, and
- Include the \$200M estimate of the impact in 2012 rates, with the difference between the forecast and actual revenue requirement impact tracked in a variance account for 2012.

Hydro One's witness Mr. Fraser stated the aggregate impact of adopting IFRS in 2012 without the exceptions to be an annual increase in revenue requirement of approximately \$200 million, all of which relates to the overhead capitalization issue. In response to a Board Staff interrogatory, Hydro One stated that the overhead at issue for capitalization is \$152 million. In relation to OM&A, if the amount of overhead not permitted in capital were charged to OM&A as suggested by Hydro One as an alternative, the effect would be to increase OM&A from the requested \$450 million to \$602 million.

The increase in revenue requirement that Hydro One has otherwise applied for is 9.8% from 2011 to 2012, presuming that its current overhead policy continues. Mr. Fraser estimated that the effect of the increase in transmission revenue requirement from 2011 to 2012 would be about 24% if the Board did not grant Hydro One's request and took the full amount of the accounting change into OM&A. Hydro One also estimated that the transmission charge represents about 7.5% of the total bill.

SEC supported Hydro One's request that the Board approve Hydro One's requested costing exception to the Board's stated policy due to concerns about rate impact. No other intervenors commented on this issue.

Board staff argued that Hydro One's request for a costing exception should not be granted. Board staff submitted that Hydro One should be required to adopt the more restrictive overhead capitalization policy provided under IFRS and address any rate impact concerns through other means. Board staff submitted that additional business measures beyond the accounting reclassification of the overhead costs at issue should be explored by Hydro One. Hydro One stated that, 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.

Board staff expressed concern that the cost drivers for allocation of overhead costs are based on the content of the capital work program and therefore may concentrate more on allocation than on whether increases in the actual expenditures on common costs are fully justified.

## Board Findings

The Board notes that Hydro One is essentially asking the Board for an exception to its stated policy regarding the capitalization of overhead costs associated with self-constructed assets. This request contravenes a purpose of the Board's policy: to bring consistency in overhead capitalization policy among the utilities rate-regulated by the Board.

The Board also notes the following uncertainties:

- Hydro One has stated in its reply submission that the company will continue in discussion with its external auditors to work towards mitigating the impact by justifying the maximum allowable classification of expenditures as capital.
- The amount of \$152 million for 2012 is the amount Hydro One states to be at issue regarding potential exclusion from amounts capitalized to the cost of self-constructed assets. There remains an amount in capital expenditures of directly attributable overhead still considered appropriate under IFRS to capitalize. Hydro One stated that the planned capital spending for 2012 is \$1,178 million. Exclusion of an amount of \$152 million attributable to training, CCF&S and Line Supervision appears to be such a large proportion as to raise questions about whether overhead capitalization, while supported by external studies may, nonetheless, be at the high end of accepted practice under Canadian GAAP. This can be seen by recognizing that the remaining \$1,026 million capital expenditures for 2012 continues to include material, labour, third party contract work, carrying charges during construction and still also includes an amount of directly attributable overhead permitted under IFRS.
- The capital expenditures for 2012 in this proceeding reflect a forecast three years in the future. Also, from audited financial statements provided in the proceeding, the actual capital expenditures have been increasing quickly, doubling from \$560 million in 2007 to the proposed amount for 2012. This increase in spending may be justified, but the Board notes that with three years forecast and with a high rate of spending increase, there is risk of inaccuracy. The Board agrees with Board staff and SEC that it does not follow that the amounts of overhead capitalized should increase proportionately in the face of a doubling of the capital program. The Board is concerned about whether the apparently large amounts of overhead not eligible for capitalization under IFRS are accurately forecast.
- Board staff submitted that Hydro One had not identified the business measures that it had taken to mitigate the overhead cost reclassification impact. Hydro One in reply stated that, "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." As a result the Board is not assured that all

possible means of mitigation beyond accepting the reclassification have been explored by Hydro One.

The Board has some sympathy for the position that Hydro One finds itself in regarding this issue. In particular, the Board notes that Hydro One is proposing to continue its existing policy for rate-setting purposes as a way to avoid having to mitigate the impact of adopting alternative policy, an approach the Board considers to be worthy and considerate of ratepayers. Hydro One acknowledges that its request for the costing exemption is based entirely on customer rate impact considerations.

The Board accepts Hydro One's observation that many utilities in Ontario have other areas of offsetting impact not available to Hydro One, particularly with regard to adjustments arising from assuming responsibility for determining asset service lives based on depreciation studies by external experts. Hydro One has already assumed this responsibility and adopted service lives based on studies by external experts. Thus for Hydro One Transmission the circumstances arising from the transition to IFRS are focused on the overhead capitalization issue.

The Board is mindful of Hydro One's concern that the amount at issue will recur each year such that the company strongly opposes the use of a deferral account since a deferral for this matter for new amounts arising each year will be required and the problem will not be resolved. The Board therefore rejects Board staff's recommendation of a deferral account as a means of addressing this problem.

The Board concludes that Hydro One should adopt IFRS accounting for overhead capitalized as part of the cost of self-constructed assets, for regulatory accounting purposes, and include an additional \$200 million in revenue requirement. The Board recognizes that this impact is significant. However, it will occur only in one year. The Board also recognizes that from the consumer's perspective the transmission charge represents only about 7.5% of the total bill and in the broader rate-setting environment a one-time adjustment will resolve the issue.

The Board is concerned that Hydro One not continue with accounting policies that are at the extreme end of what would otherwise be considered generally accepted under Canadian GAAP, and which are not accepted under IFRS. The Board considers the IFRS capitalization policies to be an appropriate evolution in the treatment of this issue from a regulatory point of view.

The Board shares the concern expressed by Board staff that cost drivers for allocation of overhead costs may concentrate more on allocation than on whether increases in the actual expenditures on common costs are fully justified. With respect to mitigation through adjustment of business measures, the Board does not see merit in artificially modifying business processes to mitigate impacts. However, the Board does expect that Hydro One will review its business processes in the normal course and make all reasonable adjustments to mitigate rate impacts.

In addition, and given that the resolution of the uncertainties discussed above may create a potential reduction of the amount ultimately included in OM&A, the Board requires Hydro One to create a variance account to capture any variance from the \$200 million revenue requirement impact attributed to this issue. Variances will be considered for disposition in a future proceeding.

## **NETWORK CHARGE DETERMINANT “HIGH 5”**

In this proceeding, Hydro One proposed to maintain the existing Network charge determinant, which has remained unchanged since implementation of the Board’s rate order in RP-1999-0044. This Network charge is on actual kW per delivery point, measured monthly, for one hour, and is the higher of the load at the hour of system peak or 85% of the non-coincident peak. The latter amount is measured only during the broad peak period 7:00 am to 7:00 pm weekdays.

AMPCO proposed changes to the Network charge determinant in Hydro One’s EB-2006-0501 transmission rates case, in the form of eliminating non-coincident demand during the 12-hour week-day peak period, and decreasing the number of months during which the coincident peak would be included. The Board did not accept the proposed changes.

In the next Hydro One transmission rates case (EB-2008-0272), AMPCO again proposed a change which is now known as the “High 5” charge determinant.

The High 5 proposal differs in two fundamental ways from the status quo.

First, it is based on coincident demand during a single hour on five different days – there is no reference to month and no reference to non-coincident demand. Rather, the charge determinant is the demand at each delivery point coincident with the highest hourly system load on each of the five days with the highest peak load.

Second, the charge in a given year is based on the delivery point’s proportion of total coincident demand during the previous year, so the monthly Network charge is a constant amount for each month during the year.

The Board did not accept the High 5 proposal in EB-2008-0272, but directed Hydro One to conduct an analysis of the proposal, together with a plan for implementation that could be used in the event that the High 5 charge determinant, or a similar proposal, might be ordered in the future.

To that end, in this proceeding, Hydro One filed a study prepared by Power Advisory Inc. (Exhibit H1/Tab 3/Schedule 1, Attachment 1), and also provided its comments on implementation matters (Exhibit H1/Tab 3/Schedule 1, section 4.1).

## 2011-12 rate years

In addition to AMPCO, CME supported the High 5 proposal. Hydro One, Board staff and all other intervenors were opposed to implementing High 5 during the period covered by this application.

AMPCO submitted that peak-load pricing promotes efficiency in public utility situations such as Hydro One's current application. VECC submitted that this generalization is too broad, and that the High 5 proposal may not result in efficient investment in transmission Network capacity because there are relatively few hours involved in the High 5 structure compared to the factors that currently drive Hydro One transmission costs.

In support of High 5, AMPCO submitted that the concept promotes efficiency in transmission by reducing or delaying the need for Network reinforcement, and in the commodity market by replacing consumption during hours of highest production cost and losses with lower cost consumption.

The Power Advisory Report filed by Hydro One concluded that the High 5 proposal does little to promote efficiency over the long run because most Network capital expenditures for the next few years are not being driven by peak load. In other words, there is little investment deferred even if load were decreased during the High 5 hours (plus a small number of additional hours when consumers might decrease their load in case it turned out to be one of the High 5 hours).

VECC suggested that the cost of shifting load away from the High 5 hours could decrease overall efficiency, as the private costs incurred by customers would exceed any savings to the system as a whole. Further, VECC submitted that, as a result of High 5 being such a small number of hours, load shifted away from those hours may fall onto hours in which the system load is still relatively high. VECC suggested two implications if this were the case:

First, AMPCO overstated the likely savings in the cost of producing the electricity commodity, as measured by HOEP, and

Second, the shifted load may add to regional peak loads and could require system reinforcement where the Network has peak hours that have been shown to be outside the overall peak if narrowly defined.

VECC submitted that adding a transmission cost incentive for load shifting, on top of the incentive already given by the HOEP, may decrease overall efficiency by incenting load shifting beyond the economic level. VECC and SEC argued that transmission rate design should not be complicated by consideration of the commodity market, and that any alleged inefficiency in the production of electricity is or should be seen to be within the commodity market.

CCC noted that in the previous EB-2006-0501 Decision, the Board placed the onus on AMPCO to show that any change is an improvement over the status quo. While acknowledging that the evidence provided in the present proceeding is more comprehensive than previously, CCC submitted that there is still not a convincing argument that High 5 is an improvement over the existing method. SEC and VECC also submitted that there is no compelling evidence for change.

Board staff filed a summary of a proposed government regulation concerning the allocation of Global Adjustment costs. The proposed regulation would use an allocation that is very similar to the High 5 allocation of Network costs proposed by AMPCO. The Power Advisory witnesses testified (TR Vol. 8, p. 28) that the regulation, if enacted, would likely create a stronger incentive to shift load away from the High 5 hours than the Network charge would. An estimate of the combined effect requires an even larger extrapolation from actual observation, which creates additional uncertainty.

## **Fairness**

AMPCO submitted that High 5 is a fair rate design because it is a more straightforward method of peak-load pricing and as such, it reflects cost causation with respect to Network facilities. AMPCO submitted that the High 5 structure is consistent with the objective of fairness, because consumers that incur private costs in order to be able to shift load are compensated for this cost through lower Network charges.

Hydro One noted that a number of alternatives were considered in the EB-2006-0501 proceeding and maintained that the existing method is a fair balancing of cost among the various consumers.

Hydro One also noted that there would be unequal treatment between customers connected to transmission delivery points and similar customers connected at a lower voltage to distribution lines. BOMA/LPMA, CCC, SEC and VECC all submitted that the High 5 structure is contrary to principles of fairness because it is not apparent how the incentive could be extended to the majority of consumers.

AMPCO also submitted that peak load pricing is fair because it reflects cost causation with respect to transmission investment requirements. Board staff and CCC submitted that the principle of fairness depends on whether the issue is cost causation of new Network facilities that might be built to accommodate future loads, or recovery of the

cost of facilities that are already in place and were put there to accommodate now-existing load. Staff and CCC submitted that the objective in the present situation is primarily a fair recovery of the cost of the existing system, which was also a conclusion in the Power Advisory study.

## **Board Findings**

While Hydro One is financially indifferent as to the outcome of this issue, for all other participants in the transmission market this issue has important financial implications.

Simply put, adoption of the High 5 charge determinant would shift cost responsibility from industrial users who are able to organize production schedules away from peak periods to the remaining customers of the transmission system. For those able to make those schedule changes, the differences will be very significant. However, what these customers do not pay in transmission rates must be made up for by all other transmission system users whether they be industrial, commercial, or residential.

The fundamental rationale for the adoption of the High 5 proposal is that it is said to address the primary cost driver for transmission system maintenance and development, which is peak period use. The proposition is that to the extent that peak usage can be minimized by shifting production schedules away from peak periods, the highest costs for system maintenance and expansion can be avoided. This, it is suggested, is a system benefit, not merely a benefit to those capable of shifting schedules.

While this rationale may be more relevant in other transmission systems, at the current time, and for the reasonably foreseeable future, it is not particularly germane to the Ontario transmission environment. Now, and for a considerable period to come, the driving force behind transmission system costs for maintenance and expansion is the renovation of the system to accommodate challenging amounts of renewable generation. Prior to the advent of an aggressive approach from the Ontario government to enable renewable generation, system peak might well be identified as the primary driver of system cost. However, that is no longer the case, and it will not be the case for some time to come.

This circumstance is one important factor in considering the advisability of adopting the High 5 methodology.

In addition, the Board is concerned that a methodology that emphasizes such a small sample, that is, five peak periods in the course of the year, could lead to anomalous and unintended results. As VECC and the Power Advisory Report contend, emphasis on the five highest hours does not adequately take into account times of system usage falling just below the five-hour levels. Very considerable system resources should be expected to be associated with a number of hours falling just outside of the top five. This top-heavy emphasis on a very small sample seems to the Board to be unwarranted, and

inconsistent with the underpinning rationale of the High 5 methodology, which is that users at the highest peak periods ought to bear the most cost. The High 5 proposal restricts that principle to an inordinately small sample.

In addition, the Board is concerned that it is only a very select group of industrial users who could take advantage of the High 5 methodology, leaving all the rest to pay the shortfall. For many industrial operations, such elasticity in production schedules is simply not available.

The Board is also interested in the regulation which allocates the Global Adjustment according to a High 5 methodology. The Global Adjustment, which is partly driven by the expansion of the renewable generation fleet, represents a very considerable proportion of the electricity bill for Ontario consumers of all classes. The Ontario government's plan to allocate this significant cost by means of the High 5 methodology should prove to be useful in assessing its potential effect were the methodology to be adopted more broadly as proposed by AMPCO.

For these reasons, the Board will not adopt the High 5 methodology for the purposes of establishing network transmission rates at this time. Given the reasons for rejection of the proposal, it is certainly open to any party to bring this proposal back to the Board at a time when costs associated with peak usage are seen to drive transmission system costs. Also, as noted above, the Board will look with interest on the effects on system usage prompted by the Global Adjustment allocation regulation, which may provide concrete and reliable evidence for the Board to consider in a future proceeding.

## EXPORT TRANSMISSION SERVICE (ETS) TARIFF

The ETS rate of \$1.00 per MWh has remained unchanged since the implementation of Board Order RP-1999-0044 at the time of market opening, May 1, 2002. The ETS rate has been an issue at previous Hydro One transmission rate applications, and was the subject of a study and report by the IESO filed in this proceeding. In this application, as recommended in the IESO report, Hydro One proposed to continue the ETS rate at \$1/MWh for 2011 and 2012.

The IESO retained Charles River Associates (CRA) to do a quantitative analysis of the future effect of several export rate scenarios, with respect to exports and wheel-through volumes, ETS tariff revenue, and the Hourly Ontario Energy Price. The rate scenarios included: continuing with the status quo, no charge and a charge of \$5/MWh. No scenarios of a tariff level between \$1 and \$5/MWh were included. The IESO extended the quantitative analysis of the scenarios, identifying the incidence of costs and benefits amongst consumers and power producers. The IESO also made a qualitative analysis of the scenarios to assess operational effects.

The results of the quantitative analyses indicated that, among the rates considered, the net Ontario benefit would be highest with the \$5/MWh rate. This happens to be the scenario with the highest consumer surplus and lowest producer surplus. The IESO did not recommend this rate, citing circumstances that had changed between early 2009 when the study began and August 2009 when it formulated its recommendation.

Among the factors that had changed was an increase in Surplus Baseload Generation (SBG), which occurs when production from baseload resources such as nuclear, wind, non-utility generators and must-run hydro facilities is greater than market demand. With the higher export tariff, SBG levels would increase further because export volume would be lower. In an SBG situation, nuclear units might be dispatched down or off, for example, which would have economic costs not adequately considered in the CRA or IESO analyses.

### 2011 Rate

Several parties endorsed the recommendation to approve the rate of \$1/MWh, along with Hydro One and the IESO. Bruce Power, the Association of Power Producers of Ontario (APPrO) and Hydro Quebec Energy Marketing Inc. recommend that the Board approve continuation of the rate in 2011. Board staff said that it could make no recommendation other than continuation of the status quo, because the evidence does not support any specific rate other than \$1/MWh.

The parties recommending a rate higher than \$1/MWh in 2011 were CCC, BOMA/LPMA, CME, Pollution Probe, SEC and VECC.

SEC submitted that the evidence before the Board supports the rate of \$5/MWh, based on the CRA study, and noted that the status quo had never had an empirical basis. SEC recommended implementation of the \$5/MWh rate in 2011 or \$3/MWh if the Board was not prepared to move to \$5/MWh in a single step.

Pollution Probe also recommended implementation of \$5/MWh in 2011.

CCC and BOMA/LPMA recommend \$2/MWh in 2011, though as noted below they differ in their recommendation for 2012.

VECC recommended that, at a minimum, the ETS tariff should be increased by the same percentage as the Network charge, which would be \$1.24/MWh in 2011. VECC submitted that the Board should give serious consideration to a time-of-use export tariff, beginning in 2011 or 2012, and recommended that the rates be \$2/MWh in the peak period and \$1/MWh in the off-peak period. In support of this recommendation, VECC pointed out that the SBG conditions occur primarily in the off-peak and would not be exacerbated by the higher rate during the peak period. VECC went on to submit that the status quo, by being lower than the rates in other jurisdictions, may have reduced the incentive of neighbouring jurisdictions to reciprocate with lower tariffs of their own. CME adopted the VECC submission.

## **2012 Rate**

With regard to the ETS rate to be set for 2012, the parties that supported the continuation of the rate at \$1/MWh for 2011 recommended the same in 2012.

SEC recommended that the rate should remain unchanged from 2011 at \$5/MWh, or failing that, \$3/MWh. Pollution Probe did not make a recommendation for 2012 separate from its recommendation of \$5/MWh in 2011. CCC recommended continuing at the rate at \$2/MWh in 2012. BOMA/LPMA recommend \$3/MWh, provided that the IESO did not identify issues or concerns that would have arisen from its experience with the higher rate during 2011.

VECC did not make a separate recommendation for 2012 concerning the time-of-use tariff but recommended that, again as a minimum, the ETS rate should increase by the same percentage as the proposed Network charge to \$1.33/MWh.

## Further Study of the ETS tariff

Board staff submitted that the IESO should analyze the market again, comparable to the CRA study but updated to reflect the considerations that led the IESO to recommend the status quo instead of the conclusions that were filed with this application. Staff submitted that the Board should be given a wider range of alternatives for the ETS, supported by quantitative evidence.

The IESO suggested that it may be appropriate to study the matter of the ETS tariff at a future time, after the effects of recent incentives for renewable energy generation will have been realized and operational experience gained by the IESO.

Except for Board staff, the parties that supported continuation of the current rate in 2011 did not make any recommendation for further study. Several parties that recommended an immediate increase in the rate also submitted that further study is not required.

Board staff, CCC, VECC, and CME submitted that the IESO should be required to submit the study in time for the next transmission rate application. SEC added that, if the study is not submitted in time for the next proceeding, the 2013 ETS rate should rise to \$5/MWh (if the Board had not already taken SEC's recommendation to do so in 2011).

Several parties submitted that it would not be useful to simply update load forecast and cost data into the methodology already employed in the current study.

Bruce Power and APPrO pointed out that one of the main assumptions in the previous study – that consumer surplus accruing to Ontario consumers will be larger if export levels and the commodity market price are lower – is no longer relevant. Because the Global Adjustment runs counter to the commodity market price, the effective price paid by Ontario consumers is nearly the same in all scenarios.

Pollution Probe and SEC submitted that the effect of a higher export rate is not necessarily to lower exports, because power producers can bid correspondingly lower prices into the electricity spot market in order to avoid SBG situations.

The IESO submitted that it is not the appropriate entity to do a rate design study. However, it appeared to not dispute that it would be the appropriate body to update the CRA and its own study if such an update is to be done. VECC submitted that Hydro One should assume the lead role, because it has the responsibility to submit a comprehensive rate proposal, including an appropriate export rate. Hydro One disagreed with this position. Board staff submitted that Hydro One should become more involved in formulating the recommendations, while submitting that the IESO should retain the lead role.

Bruce Power and APPrO submitted that the Network was built to serve domestic load, not export load. In this view, cost causation is an important objective, and power producers are not responsible for Network cost. In any case, equal rates across all users are not necessarily synonymous with fairness.

APPrO also submitted that the Board's statutory objectives include economic efficiency in generation as well as transmission. Consideration of economic efficiency in generation would include the cost to power producers of adapting to SBG situations.

Bruce Power and APPrO argued that the Board should defer to the expertise of the IESO in the matter of the ETS rate. By recommending rates for 2011 other than the rate recommended by the IESO, a number of parties are suggesting that the Board should not defer to that expertise. VECC submitted that the IESO's input should be solicited on matters affecting system operation, but that Hydro One is accountable in what should be viewed as a conventional rate design study. Further, VECC suggested that the IESO's proposed schedule for updated information and recommendations is an unacceptable and unproductive delay.

## **Board Findings**

The Board's analysis of this issue begins with the observation that the original one dollar ETS rate was established initially as a placeholder, and was not the product of an objective, principled, or programmatic study. It therefore cannot be considered to have any particular precedential value. The issue is a long-standing one, and until very recently it has not been subjected to any form of genuine analytical review. Having said that, there is little virtue in replacing one placeholder with another in the absence of evidence supporting the new value.

VECC proposes that the establishment of the ETS be predicated on the rate-making methodology and outcomes for the rest of the transmission system. While this is an attractive symmetry, there is simply no basis upon which to conclude that conventional rate-making practice is genuinely relevant to the establishment of this export rate.

The CRA study is of some assistance. While its sponsors abandoned its recommendations in light of current market conditions, particularly the higher incidence of surplus baseload generation, it is the only programmatic study that exists in this record.

That study concluded that an increase in the ETS from \$1 to \$5 optimized the net Ontario benefit. The five dollar rate, if adopted, would increase the surplus for consumers and correspondingly be expected to decrease the generator's surplus. As noted above, the CRA study did not examine the impact of rates falling between the existing one dollar rate and the five dollar rate.

The Board concludes therefore that the most pressing requirement is that a genuinely comprehensive study be undertaken to identify a range of proposed rates and the pros and cons associated with each proposed rate in time for the next transmission rate application. In the Board's view, the most appropriate party to undertake this study is the IESO. In procuring the study, the IESO should circulate the terms of reference to the Applicant and the intervenors of record in this case with a view to ensuring that the resulting study will provide detailed analysis on the issues.

This review of the terms of reference is not intended to be a strategic negotiation, but rather a technical exercise to ensure that the scope of the project is sufficiently broad and well-defined to ensure a useful and appropriate outcome. Work on this study should begin soon, to ensure completion well in advance of the time for the filing of the next transmission rates application by Hydro One.

In the interim, the Board must consider whether continuation of the one dollar placeholder is appropriate or whether some interim change to the approved rate should be made pending the development of a principle-based new rate.

The CRA study did not examine any of the rate level options falling between the one dollar placeholder and the five dollar rate recommendation which was ultimately abandoned by IESO for the reasons cited above.

It is the Board's view that the CRA study is informative to the extent that it considered the higher rate to result in a higher net Ontario benefit. While the Board respects IESO's reticence to advocate the higher rate, it does appear as though some level between one dollar and five dollars is directionally advisable.

Accordingly, the Board will direct that a change be made to the ETS rate for 2011 and 2012, increasing the rate to two dollars per MWh. In making this change the Board seeks to recognize the directional preference of the CRA study, and the absence of any particular analytical underpinning for the current rate. Subsequent panels assessing the level of this rate should not, however regard this new rate as having any particular precedential value. It is the Board's view that the new rate has more analytical support than the status quo, but that in order to arrive at a genuinely robust and valid rate, more study is required.

## TOTAL BILL IMPACTS

One issue that was raised over the course of this proceeding was whether the Board should consider total bill impacts affecting Hydro One transmission customers and not just the bill impacts associated with this specific transmission rates application.

In support of the proposition that the Board should take the broader view, on August 26, 2010 CME filed evidence prepared by Bruce Sharp of Aegent Energy Advisors Inc. entitled Ontario Electricity Total Bill Impact Analysis, August 2011 to July 2015. This analysis included a forecast of the impacts of a number of factors other than transmission rates, including the price of the commodity, taxation effects, such as the Harmonized Sales Tax, anticipated increases in distribution rates, the advent of Time of Use (TOU) pricing, and expected government initiatives.

The analysis concluded that non-residential electricity costs would increase at an annual compound rate of 8.0 to 10.4 percent (depending on usage levels) from August 2010 to July 2015. For residential customers, electricity costs would increase at an annual compound rate of 6.7 to 8.0 percent (depending on usage levels) over the same time period. It is common ground that increases of this magnitude, if realized, would be quite significant for both residential and non-residential customers.

In response to a Board staff interrogatory, CME provided additional background to the evidence including how it proposed to use the evidence in this proceeding. CME stated that,

“Having regard to the Board’s obligation under the *Ontario Energy Board Act, 1998* (the “*OEB Act*”) to protect consumers with respect to electricity prices when carrying out its responsibilities under the *Act*, a consideration by the Board of evidence of the total bill impacts customers are experiencing and facing is mandatory.”

In its argument-in-chief, Hydro One indicated that it did consider rate impacts in developing its rate proposals but did not expressly take into account extraneous cost pressures which are beyond its control. Hydro One stressed that it does not have any particular ability to take those costs into account, even if it were able to estimate them and even if it was thought appropriate to do so.

Hydro One argued that its paramount duty is to maintain and develop a safe, reliable transmission system, determining what investments are necessary to achieve the safest, most efficient and most reliable transmission system, now and in the future. Hydro One maintained that the current rate proposal, if approved, would enable Hydro One to achieve those objectives.

Hydro One submitted that it made no sense to reduce the needed funding to Hydro One for its transmission network because of the overall impact of a host of factors beyond its control. Hydro One's proposal in this case is an essential link in the chain of supply and delivery of electricity for the Province and it should not be curtailed or prevented from doing its job because of external cost pressures arising from other factors unrelated to the transmission of electricity.

CME took the lead on this issue in filing evidence as noted above. After reviewing the pricing pressures outlined in the Aegent evidence, CME submitted that the overall electricity price increases customers are likely to face over the course of Hydro One's five year planning cycle are a critical consideration when determining the overall reasonableness of the revenue requirement amounts Hydro One is asking the Board to approve.

CME also submitted that when exercising its rate-making jurisdiction under the OEB Act, the Board should give a particularly high priority to its statutory objective of protecting consumers with respect to electricity price increases. In its view, this is especially important during a period where significant overall price increases are anticipated.

CME acknowledged the Board's October 27, 2010 letter outlining three policy initiatives effecting its rate-making practice, designed to manage the pace or rate of bill increases for consumers. However, CME still emphasized that the Board's plan to proceed with these initiatives should not detract from its duty to discharge its statutory obligation in this case, and in every other rates case.

CME also argued that:

- Government policy does not override the Board's obligation to approve revenue requirements and resulting rates for Hydro One that are just and reasonable and in accordance with the Board's obligation to protect consumers with respect to electricity price increases.
- Government policy should not trump the Board's consideration of matters pertaining to economic feasibility. As an independent economic regulator, mandated by statute to carry out its responsibilities so as to protect the overall public interest, the Board should adopt a guarded approach when evaluating the utility spending implications of such policies.
- Government directives made to Hydro One in its capacity as the utility owner, stand on no higher footing than directives Enbridge Inc., the parent of Enbridge Gas Distribution Inc., might provide to its utility, or that Spectra Energy, the parent of Union Gas Limited, might provide to Union. The spending implications of such directives stand to be carefully scrutinized by the regulator for reasonableness. Formal or informal directives a utility receives from its

Government owner do not preclude the Board from considering matters pertaining to the economic feasibility and prudence of the outcomes of such directives. The Board is not obliged to approve Hydro One's spending plans because they stem from directives it has received from its owner.

CME submitted that the applied-for revenue requirement should be reduced in one or more of the following areas:

- (a) Approval of reduced Operation, Maintenance and Administration expense envelopes for 2011 and 2012;
- (b) Approval of reduced Capital Expenditure envelopes for 2011 and 2012; and/or
- (c) Approval of a reduction in Equity Return and related taxes in 2011 and 2012 to the extent that system safety and integrity is not compromised.

CME argued that if Hydro One's owner is sincerely concerned about the electricity price increases consumers are facing, then it should readily waive the amount of investment return that is not needed to support Hydro One's utility-related activities such as the dividends and related taxes Hydro One is planning to flow through to its owner in 2011 and 2012. CME maintained that the notion argued by Hydro One that temporarily reducing the equity return Hydro One realizes from its ratepayers requires taxpayers to subsidize ratepayers, lacks merit. CME submitted that by allowing Hydro One's owner to recover more than the actual costs of capital it incurs for utility purposes, ratepayers are subsidizing social programs.

Simply put, CME's submission is that in the significant electricity price increase environment that currently prevails, the appropriate regulatory response to Hydro One's application is for the Board to approve revenue requirement envelopes for 2011 and 2012 that reflect further reductions in the OM&A and Capital Expenditure envelopes of the types suggested by Board staff and other intervenors, along with a temporary disallowance of equity return and related taxes not needed to maintain system safety and integrity. CME provided a confidential schedule to their argument containing its estimates of these dividend and related tax amounts.

CCC focused its submissions on the Total Bill Impact on a decision of the Court of Appeal for Ontario in the case of *Toronto Hydro-Electric System Limited v. Ontario Energy Board*.

In that decision, the Court of Appeal made the following observation:

The principles that govern a regulated utility that operates as a monopoly differ from those that apply to private sector companies, which operate in a competitive market. The directors and officers of

unregulated companies have a fiduciary obligation to act in the best interests of the company (which is often interpreted to mean in the best interests of the shareholders) while a regulated utility must operate in a manner that balances the interests of the utility's shareholders against those of its ratepayers. If a utility fails to operate in this way, it is incumbent on the OEB to intervene in order to strike this balance and protect the interests of the ratepayers.<sup>7</sup>

CCC argued that Hydro One did not balance the interests of its shareholders and the interests of its ratepayers. With regard to the cost reductions undertaken by Hydro One in response to ministerial directions, CCC submitted that those reductions were due to the impacts of the EB-2009-0096 distribution decision and the deferral of Green Energy related projects, not made on the Company's own volition to protect the interests of consumers.

In its argument-in-chief, Hydro One stated:

"The profits earned by the company through its allowed rate of return are, ultimately, paid to the province and are used to support a host of social programs, such as, for example, our school system. If we are to reduce the allowed return because of customer impacts, this implicitly means that the taxpayers of Ontario will be subsidizing the electricity users of Ontario." (Tr., Vol. 11, p. 16)

CCC submitted that the Board should draw three conclusions from this admission.

- Hydro One does not need its requested level of ROE for commercial reasons;
- Hydro One could reduce its ROE without compromising the safety or reliability of its system; and
- Hydro One has chosen to prefer the interests of its shareholder over than of its ratepayers.

In addition, CCC submitted that the projects for which the company does not offer evidence of prudence should not be approved for recovery in rates.

CCC submitted that imperatives for a Green Energy Plan were created by the government through legislation. The Minister, in his capacity as the representative of the shareholder, provided, in the September 21, 2009 letter, the direction to Hydro One to

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<sup>7</sup> (*Toronto Hydro-Electric System Limited v. Ontario Energy Board*, 2010 ONCA 284, para 50)

begin development work on GE projects. The Minister's direction should be given no greater weight than should the direction of any other shareholder. The projects are to provide transmission links to Green Energy supply sources. The sources of supply have been approved by the OPA.

Hydro One has no role in the decision about whether the supply is required, whether the particular renewable energy source is a reasonable one, and, therefore, whether the overall transmission link is prudent. The overriding obligation of the Board is to approve just and reasonable rates, pursuant to section 78 of the OEB Act. The Board cannot, and should not do that in circumstances where Hydro One cannot provide evidence of the prudence of the overall project.

In summary, CCC submitted that:

1. the Board should find that Hydro One has failed to fulfill its obligation to balance the interests of its shareholder and that of its ratepayers;
2. given Hydro One's failure to balance the interests of its shareholder and its ratepayers, the Board is obligated to do so;
3. in order to strike the appropriate balance, the Board should further reduce Hydro One's revenue requirement to ensure that the Total Bill Impact is minimized to the extent possible;
4. the Board should not approve projects, and the cost consequences of projects, which Hydro One does not direct and for which it has not provided its own, independent evidence of prudence.

VECC supported the arguments of CCC on this issue.

In reply, Hydro One recognized and agreed that the impact upon consumers is an important factor to be considered by the Board. 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, the Board's function is also to balance the interests of the electricity system, the utility and the consumer. Hydro One's application must be assessed upon the evidentiary record, and not on matters external to Hydro One which are beyond its control and have no evidentiary basis in the proceeding.

Hydro One submitted it would be contrary to the principles of rate making to artificially suppress rates and curtail necessary capital projects and other programs 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 did not suggest that the impacts upon consumers ought to be ignored. Hydro One maintained that it had already adjusted its rate proposal in consideration of customer impact issues. Hydro One mentioned its proposed costing exception to IFRS requirements in order to avoid a \$200M increase in revenue requirement and its voluntary absorption of additional pension costs in 2011 and 2012.

Hydro One supported the Board initiatives which will assess how total bill impacts ought to be considered by the Board and other stakeholders in cost of service rate applications. Hydro One indicated that it expects to participate fully in the consultation process and submitted that this generic process is the appropriate venue to address this generic issue, not a specific transmission rates application.

Hydro One concluded by urging the Board to consider the evidence in the case, the specific supporting evidence filed to explain the reasons for the variances and increases. Hydro One urged the Board not to make what it termed to be the arbitrary reductions suggested by Board staff and intervenors.

## **Board Findings**

The Board does not accept the intervenors' arguments with respect to denying Hydro One recovery of its calculated ROE. The cost of capital is a cost element in the revenue requirement determination - not a floating discretionary surplus. What is being suggested here is a kind of collateral challenge which is unsupported by evidence going to the appropriateness of the application of the ROE formula to this utility. If it is the view of the intervenors that the cost of capital determination pursuant to the Board's Cost of Capital Report is inappropriate, they may challenge it, as recognized in the Cost of Capital Report itself. Otherwise there is a presumption that the rate arrived at by the Cost of Capital Report mechanism will be applied to every utility.

The Board recognizes that it must balance consumer impacts with the interests of shareholders and strike a balance between the interests of the electricity system, the utility and the consumer. It is important that in managing the quantum of rate increases and the pace of change, the Board not sacrifice the safety and reliability of the system. Any utility, but perhaps most notably this utility, must first and foremost ensure that its current system is appropriately robust and effective. Enhancements or expansions of the system cannot be undertaken at the expense of core reliability and safety. Elsewhere in this decision the Board has stated that expansions to the system ought to be undertaken only where it can be demonstrated that the projects at issue have been subjected to and emerged from a thoughtful, transparent and inclusive regional planning process. That planning process would necessarily include a detailed financial analysis.

The Board recognizes that Hydro One has suggested ways to reduce bill impacts with its proposals for MIFRS, absorbing the additional pension costs for the test years, reducing dividend payments and various efforts to increase productivity by its staff. However, Hydro One needs to be treated like all other regulated utilities in Ontario, and

provided with an equal opportunity to achieve a rate of return on equity, regardless of the identity of its shareholder.

The Board has ordered some reductions in this Decision that will work to reduce the bill impact on customers, based on what the Board heard in evidence and arguments. The Board also notes the October 27, 2010 announcement of its three policy initiatives to review ways of exercising its rate-making jurisdiction to manage the pace or rate of bill increases for consumers. This is the kind of generic forum where this issue, which cuts across various sectors and areas of the electricity pricing equation in Ontario, can also be addressed.

## IMPLEMENTATION MATTERS AND COST AWARDS

### Implementation

Transmission rates in Ontario have been established on a uniform basis for all transmitters in Ontario since April 30, 2002. The revenue requirements for each of the three rate pools for each of the four transmitters are added to calculate the total transmission revenue requirement for each pool. The totals for each pool are divided by the charge determinant applicable for the pool to derive the uniform transmission rate. The current Ontario Transmission Rate Schedules, effective since January 1, 2010, are shown below.

<b>Service Rate</b>	<b>Monthly Rate (\$ per kW)</b>
<b>Network</b>	2.97
<b>Line Connection</b>	0.73
<b>Transformation Connection</b>	1.71

In addition, the Ontario Uniform Transmission Rate schedules include the Export Transmission Service Rate.

The transmission revenues collected by the IESO are allocated by the IESO to each of the four transmitters on the basis of revenue allocators approved by the Board. The revenue allocators are calculated by taking the percentage of the revenue for each transmitter and dividing it by the total combined revenue of all the transmitters. The current Revenue Allocators, effective since January 1, 2010, are shown below.

<b>Transmitter</b>	<b>Network</b>	<b>Line Connection</b>	<b>Transformation Connection</b>
<b>Five Nations Inc.</b>	0.00411	0.00411	0.00411
<b>Canadian Niagara Power Inc.</b>	0.00366	0.00366	0.00366
<b>Great Lakes Power Tx Inc.</b>	0.02758	0.02758	0.02758
<b>Hydro One Networks Inc.</b>	0.96465	0.96465	0.96465
<b>Total</b>	<b>1.00000</b>	<b>1.00000</b>	<b>1.00000</b>

Hydro One applied for a transmission revenue requirement of \$1,446 million for the 2011 test year and \$1,547 million for the 2012 test year. The Board has made a

number of findings that will affect these amounts. The Board's findings will change both the charges for the three pools and the revenue allocators for each of the transmitters.

The Board directs Hydro One to file with the Board and all intervenors of record, a draft exhibit showing the final revenue requirement to reflect the Board's findings in this Decision.

In addition, at the same time, Hydro One shall file an exhibit showing the calculation of the uniform transmission rates, and revenue shares resulting from this Decision. This exhibit should include the most recent approved revenue requirements and pool load forecasts for each of the other Ontario transmitters including the recent decisions for Great Lakes Power Transmission Inc. (EB-2009-0408) and Five Nations Energy Inc. (EB-2009-0387).

Hydro One shall file these exhibits no later than 14 calendar days after the issuance of this Decision. Hydro One should provide a clear explanation of all calculations and assumptions used in deriving the amounts used in these exhibits. Intervenors shall have 7 calendar days to comment on Hydro One's exhibits.

The Board notes that all three of the remaining Ontario transmitters are approved intervenors in this proceeding.

Hydro One should respond as soon as possible to any comments by intervenors, but not later than 7 days after the deadline for comments from intervenors.

If any specific matter has not been dealt with for purposes of drafting the rate order to implement the new rates or dispose of the deferral/variance accounts, Hydro One shall clearly identify these in its filing.

### **Cost Awards**

A number of intervenors were deemed eligible for cost awards in this proceeding. On June 28, 2010, Procedural Order No. 1 was issued with the finding that the following parties were eligible for a cost award: Association of Major Power Consumers in Ontario, Consumers Council of Canada, Canadian Manufacturers and Exporters, Energy Probe, Pollution Probe, School Energy Coalition, Vulnerable Energy Consumers Coalition, Association of Power Producers in Ontario, London Property Management Association, and the Building Owners and Managers Association of the Greater Toronto Area.

A cost awards decision will be issued after the steps set out below are completed.

1. Intervenors eligible for cost awards shall file with the Board and forward to Hydro One their respective cost claims within 35 days from the date of this Decision.
2. Hydro One may file with the Board and forward to intervenors eligible for cost awards any objections to the claimed costs within 40 days from the date of this Decision.
3. Intervenors, whose cost claims have been objected to, may file with the Board and forward to Hydro One any responses to any objections for cost claims within 47 days of the date of this Decision.

Hydro One Networks Inc. shall pay the Board's costs of and incidental to, this proceeding upon receipt of the Board's invoice.

**DATED** at Toronto, December 23, 2010

**ONTARIO ENERGY BOARD**

*Original Signed By*

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Paul Sommerville  
Presiding Member

*Original Signed By*

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Ken Quesnelle  
Member

*Original Signed By*

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Paula Conboy  
Member

**APPENDIX A**

**HYDRO ONE NETWORKS INC.  
2011 AND 2012 ELECTRICITY TRANSMISSION  
REVENUE REQUIREMENT AND RATES**

**DECISION WITH REASONS**

**BOARD FILE NO. EB-2010-0002**

**PROCEDURAL DETAILS  
INCLUDING LISTS OF PARTIES AND WITNESSES**

**DECEMBER 23, 2010**

## **PROCEDURAL DETAILS INCLUDING LISTS OF PARTIES AND WITNESSES**

### **THE PROCEEDING**

On May 19, 2010 Hydro One Networks Inc. (“Hydro One”) filed an application for 2011 and 2012 transmission and revenue requirement and rates. The Board assigned file number EB-2010-0002 to the application and on June 7, 2010, the Board issued a Letter of Direction and Notice of Application to Hydro One Networks Inc.

Hydro One confirmed the that it had fulfilled the service and publishing requirements found in the Letter of Direction when it filed is Service Affidavit with the Board on July 19, 2010.

Hydro One indicated in its Notice that if the application was approved as filed, the resulting increase in the Hydro One Transmission Revenue Requirement would be 15.0% in 2011 and 7.0% in 2012. These increases represent an estimated average increase on total customer bills of 1.2% in 2011 and 0.7% in 2012. For a residential customer consuming 800 kWh per month, the estimated increase on the customer’s total monthly bill is \$1.39 in 2011 and \$1.00 in 2012.

In response to the Notice, the Board received 27 requests for intervenor status, which it approved. The Board also received 13 Letters of Comment from Ontario ratepayers, expressing concern with the proposed rate increases in 2011 and 2012.

The Board issued Procedural Order No.1 on June 28, 2010, establishing the procedural schedule for a number of early events. The Board indicated that it intended to proceed by way of an oral hearing preceded by written interrogatories and a settlement conference. The Board attached a draft issues list to the procedural order and invited submissions on the items on the list from Hydro One and the intervenors for the Board’s consideration.

Hydro One brought a motion before the Board on June 16, 2010 requesting an Order severing the issue of the AMPCO proposal to alter the method of determining the transmission network charge, termed the “High 5 Proposal” (Issue 8.1), for review and assessment in a separate generic proceeding. The Board heard this motion July 20, 2010 and denied the motion in an oral decision delivered on that day.

The Board also issued its decision on the draft issues list in the same July 20, 2010 oral decision.

A copy of the decision on the motion is attached as Appendix B and the approved Issues List is attached as Appendix C.

Procedural Order No. 2 was issued on July 21, 2010 with the Board's approved Issues List.

CME brought a motion before the Board on the first day of the oral hearing September 20, 2010 requesting an order requiring Hydro One to produce certain materials provided to the Hydro One Board of Directors and requested in CME Interrogatories 1 and 2. The Board granted the motion in an oral decision on September 20, 2010.

A copy of the decision on the CME motion is attached as Appendix D.

Two intervenors filed evidence before the Board: AMPCO provided evidence on the High 5 charge determinant issue (Exhibit M-1), and CME provided evidence on Total Ontario Electricity Bill Impacts (Exhibit N-1).

A settlement conference for this proceeding was held on September 16, 2010, however no settlement was achieved.

The oral hearing for this proceeding took place on September 20, 21, 23, 24, 27, 28 and October 1, 4, and 5 2010. Hydro One presented oral argument-In-chief on October 7, 2010. The IESO filed its submissions on October 15, 2010. Board staff and intervenor submissions were submitted on October 22, 2010 and November 2, 2010 respectively. Hydro One submitted its reply argument on November 12, 2010.

## **PARTICIPANTS AND REPRESENTATIVES**

A list of participants and their representatives who were active either at the oral hearing or at another stage of the proceeding is shown below. A complete list of intervenors is available at the Board's offices.

Board Counsel and Staff	Jennifer Lea Maureen Helt  Harold Thiessen Rudra Mukherji
Hydro One Networks Inc.	Don Rogers Anita Varjadic  Allan Cowan James Malenfant
Society of Energy Professionals	Richard Long

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Pollution Probe	Basil Alexander
Consumers Council of Canada	Robert Warren
Canadian Manufacturers and Exporters	Peter Thompson Vince DeRose
Association of Major Power Consumers of Ontario	David Crocker Shelley Grice
Energy Probe Research Foundation	Peter Faye David MacIntosh
School Energy Coalition	Jay Shepherd
Building Owners and Managers Association of the GTA and the London Property Management Association	Randy Aiken
Independent Electricity System Operator	Brian Rivard Carl Burrell
Green Energy Coalition	David Poch
Hydro-Quebec Energy Marketing	Mark Rodger
Association of Power Producers of Ontario and Five Nations Energy Inc.	Richard Long Lucas Thacker
Vulnerable Energy Consumers' Coalition	Michael Buonaguro
Brookfield Energy Marketing Inc.	Charles Keizer
Power Workers' Union	Richard Stephenson Bayu Kidane

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**WITNESSES**

There were 24 witnesses who testified at the oral hearing.

The following Hydro One employees appeared as witnesses:

<i>Bing Young</i>	<b>Director, Transmission System Development</b>
Nairn McQueen	Senior Vice-President, Engineering and Construction Services
Peter Gregg	Senior Vice-President, Corporate and Regulatory Affairs
George Juhn	Director, Sustainment Investment Planning, Asset Management
Carmine Marcello	Senior Vice-President, Asset Management
Andrew Spencer	Manager, Sustainment Investment Planning, Asset Management
Paul Tremblay	Director, Network Operating Grid Operations
Debra Vines	Director, Corporate Planning and Regulatory Finance
Keith McDonell	Manager, Human Resources Operations
Tom Goldie	Senior Vice-President, Corporate Services
Mike Winters	Chief Information Officer
Sandy Struthers	Senior Vice-President and Chief Financial Officer
Colin Fraser	Manager, Financial Reporting and Accounting Policy
Stanley But	Manager, Economics and Load Forecasting

Henry Andre	Manager, Transmission and Distribution Pricing, Regulatory Affairs
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In addition, Hydro One called the following additional witnesses:

Mitchell Rothman	Managing Consultant, Power Advisory LLC
John Dalton	President, Power Advisory LLC
Robert Yardley	Executive Advisor, PA Consulting

Hydro One also presented two Independent Electricity System Operator (IESO) witnesses:

Darren Finkbeiner	Manager, Market Development, IESO
Ira Shavel	Vice-President, Charles River Associates

Witnesses called by the intervenor the Association of Major Power Consumers in Ontario:

Adam White	President and CEO, AITIA Analytical Inc.
Anindya Sen	Associate Professor, Economics, University of Waterloo, Waterloo Ontario
Darren MacDonald	Director of Energy, Gerdau Ameristeel Corporation
Paul Dottori	Vice-President, Energy Environment and Technology, Tembec Inc.

**APPENDIX B**

**HYDRO ONE NETWORKS INC.  
2011 AND 2012 ELECTRICITY TRANSMISSION  
REVENUE REQUIREMENT AND RATES**

**DECISION WITH REASONS**

**BOARD FILE NO. EB-2010-0002**

**DECISION ON HYDRO ONE MOTION**

**DECEMBER 23, 2010**

**EB-2010-0002**

**Transcript: Motion Hearing, July 20, 2010, page 29**

**DECISION ON MOTION:**

MR. SOMMERVILLE: The Board has reached a decision on the motion, and will provide our decision on that now, to be followed by our decision with respect to the rest of the Issues List.

The Board denies the motion. It is the Board's view that severing the so-called H5 charge determinant proposal from this proceeding is both inappropriate and inefficient. It is the Board's finding that the parties necessary for appropriate consideration of the matter are, in fact, parties to this case, and they will have the usual opportunities to file, challenge, support, and test all of the evidence surrounding the proposal.

The Board will consider making provision for a technical conference in September to deal with this, to deal with this issue, should it seem to be advisable.

The Board, in considering the issue, will be mindful of the general desirability of having rates -- a rates decision in place to be effective January 1st, 2010, and the timing issues -- I beg your pardon, 2011 -- and the timing issues elucidated by IESO and Hydro One.

So it is the Board's view that we will consider this issue as originally drafted in the draft Issues List, 8.1, in this proceeding.

**APPENDIX C**

**HYDRO ONE NETWORKS INC.  
2011 AND 2012 ELECTRICITY TRANSMISSION  
REVENUE REQUIREMENT AND RATES**

**DECISION WITH REASONS**

**BOARD FILE NO. EB-2010-0002**

**ISSUES LIST**

**DECEMBER 23, 2010**

**HYDRO ONE NETWORKS INC.  
EB-2010-0002  
APPROVED ISSUES LIST**

**1. GENERAL**

- 1.1 Has Hydro One responded appropriately to all relevant Board directions from previous proceedings?
- 1.2 Are Hydro One's economic and business planning assumptions for 2011/2012 appropriate?
- 1.3 Is the overall increase in 2011 and 2012 revenue requirement reasonable?

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

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

- 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?
- 3.6 Are the amounts proposed to be included in the 2011 and 2012 revenue requirements for income and other taxes appropriate?
- 3.7 Is Hydro One Networks' proposed depreciation expense for 2011 and 2012 appropriate?

#### **4. CAPITAL EXPENDITURES and RATE BASE**

- 4.1 Are the amounts proposed for rate base in 2011 and 2012 appropriate?
- 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?
- 4.3 Are the proposed 2011 and 2012 levels of Shared Services and Other Capital expenditures appropriate?
- 4.4 Are the methodologies used to allocate shared services and other capital expenditures to the transmission business, appropriate? 3.7 Is Hydro One Networks' proposed depreciation expense for 2011 and 2012 appropriate?
- 4.5 Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?
- 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?

#### **5. COST OF CAPITAL/CAPITAL STRUCTURE**

- 5.1 Is the proposed capital structure 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?

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

## **6. DEFERRAL/VARIANCE ACCOUNTS**

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

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

6.3 Are the proposed new Deferral and Variance Accounts appropriate?

## **7. COST ALLOCATION**

7.1 Is the cost allocation proposed by Hydro One appropriate?

## **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?

## **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?

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

**APPENDIX D**

**HYDRO ONE NETWORKS INC.  
2011 AND 2012 ELECTRICITY TRANSMISSION  
REVENUE REQUIREMENT AND RATES**

**DECISION WITH REASONS**

**BOARD FILE NO. EB-2010-0002**

**DECISION ON CME MOTION**

**DECEMBER 23, 2010**

**EB-2010-0002**

**Transcript: Oral Hearing, Volume 1, September 21, 2010, page 41**

**DECISION:**

MR. SOMMERVILLE: Thank you. Please be seated. The Board has arrived at a decision with respect to the motion.

The motion is granted. In the Board's view, there is probative value in this documentation of the evolution of the company's thought with respect to its business plan, which ultimately culminated in the application that we're dealing with in this case.

The Board notes that these are highly formalized documents, seeking the approval of the board, signed by the president and the chief financial officer of the corporation. The fact that the approval sought was not limited, nor were the documents limited, to the transmission side of the business is not fatal to their value insofar as they demonstrate and seek the approval of the board with respect to the business plan which culminated in the application.

The Board does consider that it has the discretion to deny admissibility to materials where the probative value is obviously outweighed by the prejudicial effect of the material. The Board does not consider this to be such a case.

In the Board's view, the prejudicial effect, specifically the creation of an inhibition of discussion around the Hydro One board table, is not convincing in this case. The highly detailed and formal nature of these documents, as I have noted, signed by the president and the chief financial officer, suggest that they are obviously not records of discourse, conversation, debate, nor could they consider it to be genuinely formative with respect to the points of view expressed in the documents.

So on that basis, the Board grants the motion.