

**Hydro One Networks Inc.**

8<sup>th</sup> Floor, South Tower  
483 Bay Street  
Toronto, Ontario M5G 2P5  
www.HydroOne.com

Tel: (416) 345-5707  
Fax: (416) 345-5866  
Andrew.Skalski@HydroOne.com

**Andrew Skalski**

Director – Major Projects and Partnerships  
Regulatory Affairs



BY COURIER

July 18, 2011

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

Dear Ms. Walli:

**EB-2010-0345 – Niagara West Transformation Corporation Transmission Revenue Requirement Application –Hydro One Networks Final Argument**

---

I am attaching two (2) copies of Hydro One Networks ("Hydro One") Argument on the above mentioned proceeding. A copy of this cover letter and the attached Argument have been filed in text-searchable electronic form through the Ontario Energy Board's Regulatory Electronic Submission System and the confirmation slip is also enclosed.

Sincerely,

ORIGINAL SIGNED BY ANDREW SKALSKI

Andrew Skalski

c. EB-2010-0345-Intervenors

**EB-2010-0345**  
**NWTC Rates Application**

**HYDRO ONE NETWORKS INC. SUBMISSION**

Hydro One Networks Inc. (Hydro One) makes the following submissions in respect of the rates application of Niagara West Transformation Corporation (NWTC).

In Hydro One's view, NWTC's application for rates has revealed several issues for the Board to consider. These issues include licensing matters which go beyond the scope of a typical rates proceeding. Hydro One believes it would be useful to comment on these issues in order to assist the Board in this and future applications by LDCs who wish to self-provide transmission service as a licensed transmitter.

**Rate to be Charged and Recovered and the Appropriate Economic Signal**

By way of interrogatory response and subsequently confirmed at the Technical Conference and in its Argument-in-Chief (AIC), NWTC has amended its application to request that the Board allow it to continue with its current "standalone" arrangement from the pool and charge the existing Uniform Transmission Rate (UTR) of \$1.77 per kW for Transformation Connection service. This amended request replaces NWTC's original request to become part of the UTR pool and have its revenue requirement and charge determinants included in the determination of the pool rate.

Hydro One supports NWTC's amended request to continue with its standalone arrangement from the transmission rates pool, and to charge the current pool rate of \$1.77 per kW for its service. In Hydro One's view, this is the best short-term solution under the circumstances. Allowing NWTC to remain apart from the pool has the clear benefit of avoiding the upward creep, however small, of the pool rate that would otherwise have occurred if NWTC's higher equivalent cost of service of \$1.94 per kW had been added to

1 the pool [Ref. Hydro One IR 7(b)]. Avoiding the addition of higher-than-average cost  
2 providers to the pool is to be preferred where possible.

3  
4 However, while supportive of NWTC's request to charge the pool rate, Hydro One does  
5 not believe that NWTC should be allowed to recover the full pool rate in return for  
6 providing service. In Hydro One's view, allowing NWTC to recover the full pool rate  
7 would send an inappropriate economic signal to it or other distribution companies that are  
8 contemplating self-providing transformation service. The appropriate economic signal is  
9 based on the alternative cost to provide that service, which the Board should set as the  
10 benchmark or reference price. If the reference price is less than the cost of self-provision,  
11 the reference price should prevail. In NWTC's case, as discussed at the Technical  
12 Conference at Transcript 51, Hydro One can provide transformation service to NWTC's  
13 customers at a cost to the pool of \$1.73 per kW. This is less than both the \$1.77 pool rate  
14 that NWTC is requesting that it be allowed to charge and recover, and NWTC's \$1.94  
15 equivalent rate based on its own cost of service. In Hydro One's view, \$1.73 should  
16 therefore be set as the reference price to reflect the base cost of providing service, and  
17 NWTC should be permitted to recover no more than that benchmark. That would send  
18 the correct economic signal.

19  
20 In suggesting that the reference price should be set as the benchmark, Hydro One is  
21 mindful of the economic consequences to the pool that occur when distribution customers  
22 elect to self-provide. As discussed at Technical Conference Transcript 52 – 54, if  
23 NWTC's customers were receiving transformation service from Hydro One instead of  
24 effectively self-providing that service through NWTC, they would pay the pool rate of  
25 \$1.77, and the difference between the pool rate and Hydro One's cost to provide service  
26 of \$1.73 would contribute to keeping the pool rate lower for all participants. That 4 cent  
27 per kW differential therefore represents a lost contribution that the pool would otherwise  
28 receive if NWTC's customers were continuing to obtain pool service for the load  
29 supplied by NWTC. While customers have a right under the TSC to build, own and  
30 operate their own facilities, in Hydro One's view the decision to build dedicated facilities

1 should be based on a correct reading of the economics of the situation, and the Board  
2 should reinforce that reading by ensuring the correct economic signal is set. In this case,  
3 that signal would be to allow NWTC to recover at most the lowest-cost alternative to  
4 provide service of \$1.73 per kW. While the 4 cent differential between that and the pool  
5 rate is small, and it therefore could be argued that the issue is immaterial, in Hydro One's  
6 view the principle is important. NWTC has acknowledged in its AIC [para. 24], in  
7 response to a question posed by Board Staff, that its capital-raising capability will not be  
8 affected if it receives the \$1.77 pool rate instead of recovering its full cost of service.  
9 The minor impact of a further downward adjustment to the \$1.73 rate is therefore  
10 unlikely to cause a change in that regard. The 4 cent per kW difference between what  
11 NWTC's customers would pay and NWTC's allowed recovery could be recorded in a  
12 variance account, and remitted by NWTC to the IESO on behalf of the pool on an annual  
13 basis.

#### 14 15 **Revenue Requirement**

16  
17 In its AIC at paragraph 23, NWTC has put forward an amended revenue requirement for  
18 approval of \$767,092. The amended revenue requirement is based on a revised ROE  
19 assumption of 7.00%, as detailed in paragraph 22, to align with NWTC's lowered ROE  
20 expectations associated with charging the \$1.77 pool rate instead of recovering its full  
21 cost of service. If the Board accepts Hydro One's suggestion to set the approved  
22 recovery at \$1.73, the ROE assumption will need further amendment.

23  
24 Another change to its amended revenue requirement that NWTC has not made, but that  
25 Hydro One submits should be, is to revise NWTC's return on capital to reflect its actual  
26 capital structure. As revealed in its response to Board Staff IR 16, NWTC's 2011 capital  
27 structure is approximately 80/20 Debt to Equity, compared with the deemed capital  
28 structure of 60/40 Debt to Equity used in the calculation of its revenue requirement.  
29 Given that debt is a lower-cost source of funds than equity, the use of the deemed capital  
30 structure with its higher proportion of higher-cost equity means that NWTC's test-year

1 return on capital included in its revenue requirement is over-stated relative to its actual  
 2 costs, and its reported revenue deficiency of \$118,830 is similarly overstated. If not  
 3 adjusted, this would lead to an over-recovery by NWTC relative to its actual costs.  
 4 While it is customary for there to be minor differences between a utility's deemed and  
 5 actual capital structures based on the timing of debt and equity issues, in this case the  
 6 difference is unusually large as NWTC is (and has been) using a high level of leverage to  
 7 lower its actual financing costs. In Hydro One's view, NWTC's revenue requirement  
 8 should be adjusted downward to reflect this fact so that NWTC does not derive a  
 9 financial benefit from its use of a higher-than-deemed amount of leverage at the expense  
 10 of its customers.

11  
 12 Hydro One notes that Board Staff, in its Submission at page 12, comments on and has  
 13 concerns in its submission about NWTC's preparedness to accept a lower ROE, were the  
 14 Board to approve NWTC's request to charge and recover the \$1. 77 pool rate, which is  
 15 below its equivalent cost of service. In Hydro One's view, NWTC's preparedness to  
 16 accept the lower pool rate is likely partly due to its recognition of the contemplated over-  
 17 recovery of financing costs embedded in its rates application, which over-recovery should  
 18 not be allowed.

## 19 20 **Long-Term Solution**

21  
 22 Although Hydro One supports as the best short-term solution the use by NWTC of a  
 23 specific charge for the transformation service it provides, Hydro One submits that the  
 24 better long-term solution is to have NWTC's facilities deemed as distribution assets and  
 25 owned by one or both of its current LDC customers, Grimsby Power and Niagara Pen  
 26 Energy. This would be consistent with the approach taken by other LDCs that self-  
 27 provide transformation service and it would avoid the licensing and Code-compliance  
 28 concerns that were revealed during the course of the current proceeding. These concerns  
 29 were discussed at the Technical Conference [Ref. Tr. 65 – 69] and were also the subject  
 30 of Hydro One IR 11. The concerns include such things as NWTC's lack of Board-

1 approved connection procedures and its seeming unfamiliarity with the obligation to  
2 serve of licensed transmitters in regard to new load or generation. This unfamiliarity was  
3 reinforced in NWTC's AIC. For example, at paragraph 35 of its AIC NWTC noted that  
4 Hydro One has a list of constrained stations which are limiting the amount of generation  
5 that they can accommodate. In NWTC's view, this is similar to its own situation and  
6 appears to provide a justification for its refusal to connect new generation. Nowhere in  
7 NWTC's Argument, or in the discussion that occurred at the Technical Conference, is  
8 there an acknowledgement by NWTC of the obligation of a licensed transmitter to  
9 provide a means of connection to those who request it, including the cost of providing  
10 any needed upgrades to allow the connection to proceed and the customer's share of such  
11 costs under Transmission System Code cost responsibility rules. In Hydro One's case,  
12 this means that the station constraints identified could be temporary, depending on  
13 whether the customer elects to proceed with the work, whereas in NWTC's case it  
14 appears to consider that its system constraints are permanent and require no action on its  
15 part to remedy. This is contrary to its licence requirements.

16  
17 A further example of non-compliance relates to NWTC's aggregation of load. As  
18 clarified during the Technical Conference, NWTC is not acting as a transmitter in the  
19 same manner as other transmitters that are a party to the UTR arrangement. This is  
20 evidenced by the fact that NWTC charges NPEI and Grimsby Hydro for transformation  
21 service based on the aggregated monthly non-coincident peak (NCP) load of both utilities  
22 [Ref. Tr. 49], whereas if NPEI and Grimsby were connected to any of the transmitters  
23 subject to the UTR arrangement they would have to pay for transformation service on the  
24 basis of their individual NCP loads. Although NWTC attempts to address this issue in  
25 para. 28 and 29 of its AIC, in fact those paragraphs do not refer to the basis for charging  
26 NPEI and Grimsby for transformation service but rather refer to adjustments related to  
27 meeting the incremental load requirements per the original March 28, 2005 Board Order.  
28 Hydro One's observation therefore remains that NWTC is not compliant with standard  
29 transmission load aggregation and billing practices.

1 While not wishing to dwell on NWTC's compliance shortcomings, it is apparent that  
2 NWTC is not in full compliance with its transmission licence or the Code. In a way this  
3 is understandable given that NWTC considers its role, as noted in its AIC at paragraphs 4  
4 – 6, to be simply a dedicated provider of transformation service to its two LDC  
5 customers. Given NWTC's limited role, Hydro One suggests that it would be best in the  
6 long term to have the regulatory treatment of NWTC's sole facility match its limited  
7 business purpose (i.e., recognize the facility as a deemed distribution asset), rather than  
8 force NWTC to act as a full-fledged transmitter and comply with all of the associated  
9 licence and Code requirements.

10  
11 To that end, Hydro One suggests that any approval the Board grants in regard to the rate  
12 NWTC charges should be time-limited, as a means to encourage NWTC and its owners  
13 to move to a resolution of its ownership situation. NWTC indicated at the Technical  
14 Conference [Ref. Tr. 56] that such discussions, involving the purchase of the facility by  
15 one of its LDC customers, have been initiated. Hydro One further suggests that the  
16 Board could also amend NWTC's transmission licence with a similar time limitation as  
17 an additional encouragement towards that resolution.

#### 18 19 **Implications for Future Transmission Licence Applications**

20  
21 In Hydro One's view the issues that have arisen in this proceeding concerning Code and  
22 Licence compliance are likely to be generic, should other LDCs opt in the future to self-  
23 provide transformation service as a licensed transmitter. This is due to the limited  
24 purpose of the facility and hence of the transmission owner/operator, as discussed above.

25  
26 Hydro One submits that the simplest and easiest solution to the compliance issues that are  
27 likely to arise with respect to distributors engaging in limited-purpose transmission  
28 activities is to deem the facilities as distribution assets. Decisions to self-provide  
29 transmission services should also be subject to the appropriate prudence review.

**Further Comments on Board Staff's Submission**

Hydro One is sympathetic to the concerns and issues raised by Board Staff in its submission. Hydro One notes that Staff's submission reinforces the points made above regarding the difficulties for all parties, including the Board, in reviewing what is in almost all respects a non-standard application by NWTC that raises both rates and licensing concerns. In Hydro One's view, the issues and concerns raised by Staff are a further argument towards encouraging NWTC's transition to a deemed distribution facility for its transmission assets.

All of which is respectfully submitted.