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BY COURIER

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

Dear Ms. Walli:

EB-2010-0379 – OEB Consultation on Defining and Measuring Performance of Electricity Transmitters and Distributors - Hydro One Networks' Comments on the Consultants Reports

Hydro One Networks Inc. ("Hydro One") is providing the attached comments and responses to the List of Questions for Written Comment set out in Appendix B of the Ontario Energy Board ("the Board") letter of May 30, 2013.

The Board states in its letter that the list of questions is not intended to be exhaustive and invites stakeholders to address other matters in relation to benchmarking and/or rate adjustment in their comments. Accordingly, Hydro One has done so in its comments.

While we concur that costs are the driving force in rate adjustments we suggest that the other elements in the Balanced Scorecard drafted by the Board be considered in the rate setting process. As noted in some of the papers submitted, customer service and reliability are integral to the rate setting process.

We look forward to our continued participation in the Defining and Measuring Performance process.

Sincerely,

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Susan Frank

Hydro One's Responses to the Board's Questions

The Inflation Factor

1. For each expert's recommended approach (including PEG's):
   a. Is the proposed approach appropriate? Does it meet the Board's policy direction noted above?

      The range in the inflation factor interpretations from the four experts is a concern. Insights shown in the EDA and PWU reports should be considered. The PEG approach may not be appropriate as it may subject customers to rate shock due to inflation factor volatility. See part "c".

   b. Are the recommended sub-indices appropriate?

      See "a" above.

   c. Should the Board be concerned with volatility in the inflation factor?

      PEG's "Three Factor" recommendation introduces some volatility as it is highly sensitive to shifts in interest rates. If such an approach is used, the Board would need to monitor volatility of inflation and adjust accordingly should it exceed a certain band width.

      The PSE recommendation to use the PEG "Three Factor" inflation factor with TWA price for the capital component appears to be far less volatile and would allow the use of the actual annual inflation number rather than having to smooth the number over a three year period.

      The EDA recommendation to implement a regulatory formula using a smoothing mechanism would reduce rate shock to customers. Using an increased inflation factor during periods when the industry-specific rate of inflation is below the broader inflation measures, and using the differential as an offset during periods when the industry specific inflation factor is higher would also be less volatile than PEG's recommendation.

2. What is your preferred approach and why?

   The EDA approach is preferable due to its built in smoothing mechanism.

The Productivity Factor

3. For each expert's recommended approach (including PEG's):
   a. Is the proposed approach appropriate? Does it meet the Board's policy direction noted above?

   The effect of policy initiatives with material impact, such as the Green Energy Act, is best addressed in the EDA and PWU reports but not in the PEG report. The magnitude of these initiatives and the associated costs have major impacts on the inputs while they are not reflected in the productivity outputs. Therefore the PEG recommendation may not be appropriate as it does not address anomalous cost patterns in the electricity distribution industry.

   b. Are the recommended inputs and outputs appropriate?

   The PEG report is more heavily weighted on historical data rather than on current and emerging factors affecting the Ontario distribution industry. The other expert reports consider more recent historical data which may be more indicative of the current environment (e.g. declining taxes and changes in bad debt).

4. What is the appropriate value for an Ontario electricity distribution Total Factor Productivity trend? Why?

   Hydro One believes it is more important for the Board to determine the correct methodology to be used going forward which would in turn yield an appropriate value. It appears that all of the experts are experiencing difficulty in making this determination, given the lack of evidence in the various papers (with the possible exception of the PWU). This makes it difficult to establish an appropriate value or methodology at this point.

Total Cost Benchmarking

5. For each expert's recommended approach (including PEG's):
   a. What do you perceive to be the strengths and weakness of the various consultants' approaches?

   The need to include reliability in any cost calculation is only addressed by the PWU and to a lesser extent PSE. As noted in the Board preamble it is both distributor customer service and cost performance outcomes that are to be considered. This is also recognized by other regulators, although only the PWU presents evidence to support this position.

   The arguments for the inclusion/exclusion of Toronto Hydro and Hydro One are more persuasive in the PWU, EDA and PSE reports than in PEG's report.

b. Are the outputs and recommended business condition variables appropriate?

The impacts of the new policy initiatives are best recognized in the EDA and PWU papers. The lack of same in PEG's may be an issue.

6. What is your preferred approach and why?

The impact of reliability on costs is significant and this is recognized in the PWU paper.
Therefore it would appear to be appropriate to do further research on the correlation among reliability, costs and rates prior to making a decision on the rate process.

As noted in the PWU paper, this could be an opportunity to improve performance (e.g. safety, reliability, line losses) rather than just cutting costs.

7. In PEG's unit cost/peer group model:
   a. Are the recommended peer groups appropriate?

As noted by the experts other than PEG, the use of peer groups is not desirable because this methodology could lead to erroneous decisions stemming from unfair groupings. The need to use peer groups is not proven and therefore not appropriate.

   b. If not, what peer groups would you recommend and why?

See "a" above.

   c. Should each distributor's unit cost be compared to the average unit cost for the peer group or to the median unit cost for the peer group?

See "a" above.

<u>Low Voltage Rates</u>

8. In general, is the approach to dealing with differences in HV & LV services modeled by PEG appropriate?

All costs to provide distribution service, whether HV or LV, should be included in calculations associated with the Board's benchmarking methodology. These costs should include charges levied by transmitters and host distributors to those distributors that use others' "upstream" assets to supply electricity to their customers. Similarly, costs incurred by distributors who have built, own and maintain their own lines to provide electricity to their customers should also be included.

Distributors are charged for the ST assets associated with their specific connection configurations using the pooled costs of the class of ST assets <u>serving them</u>. Like most

OEB-approved rates charged by distributors, the ST rates do not reflect the exact costs specific to the assets used to serve them. For example, if a distributor is charged low voltage distribution station (LVDS) costs, it is paying an average pooled cost associated with host distributor's ownership and maintenance of its LVDS assets, and not the cost for the specific LVDS serving it.

9. Specific to LV services, on December 6, 2012 Board staff posted on the Board's website a set of data that was provided by Hydro One to support the empirical analysis on payments to Hydro One for LV service for each distribution company for the period 2002-2011 (Summary of Hydro One Low Voltage Charges to Distributors 2002–2011). During the Stakeholder Conference the issue of appropriate LV costs to be included in the benchmarking models was raised.

   a. Which of the following LV-related charges should be included in total cost benchmarking? If you recommend excluding a charge, please explain.

   - Common ST Lines:
     Include - The ST costs Hydro One charges embedded distributors reflect the costs incurred in getting electricity from the transmission system to their distribution system. If a distributor is being charged for Common ST Lines it is because one or more of its delivery points is making use of ST Lines and therefore this charge should be included.

   - HVDS-HIGH:
     Include - The HVDS-high rate is set equivalent to the Retail Transmission Service Rate ("RTSR") – transformation, since customers in the ST group can obtain transformation from above 50 kV to a voltage between 44 kV and 13.8 kV either through the use of an HVDS–high or a Transformer Station. Customers that obtain supply through TS owned by Hydro One Transmission are charged the RTSR – transformation. If PEG determines it appropriate that the RTSR – transformation charges should be included in the benchmarking then HVDS-High charges should also be included.

   - HVDS-LOW:
     Include - Consistent with Hydro One's current approved rate structure, the HVDS-low rate is set to be the sum of the HVDS-high rate and LVDS rate. HVDS-low stations supply voltage at or below 12.5 kV. If PEG determines it appropriate that the RTSR – transformation charges should be included in the benchmarking then HVDS-Low charges should also be included.

   - LVDS:
     Include - LVDSs transform power from between 44 kV and 13.8 kV, to under 13.8 kV. The rate is set to recover the portion of the Cost Allocation Methodology dollars attributable to LVDSs. If a distributor is being charged for LVDSs it is because one or more of its delivery points is making use of LVDSs and therefore this charge should be included.

- Meter Charge:
  Include - Most of the customers in the ST group provide their own metering facilities. To reflect this, Hydro One has an additional fixed charge applicable only to customers for whom Hydro One provides metering facilities.

- Monthly Service Charge:
  Include - Hydro One has a fixed charge per delivery point in cases where a customer uses any ST facilities (e.g. Common ST lines, Specific ST Lines, HVDSs or LVDSs).

- Shared LV Line – ***equivalent to Common ST Line***
- Shared LVDS – ***equivalent to LVDS***
- Specific Distribution Line – ***equivalent to Specific Primary Line***
- Specific LV Line – ***equivalent to Specific ST Line***

- Specific Primary Lines:
  Include - A line section is "Specific" if it supplies solely one distributor and is within that distributor's territory. Primary lines are between 12.5 kV and 4.16 kV. These Specific Line rates are set at values which would recover the costs attributable to Primary lines. Specific Line rates are charged by km rather than by kW. If a distributor is being charged for Specific Primary Lines it is because one or more of its delivery points is making use of Specific Primary Lines and therefore this charge should be included.

- Specific ST Lines
  Include - A line section is "Specific" if it supplies solely one distributor and is within that distributor's territory. ST lines are defined by Hydro One as those between 44 kV and 13.8 kV. Specific Line rates are charged by km rather than by kW. If a distributor is being charged for Specific ST Lines it is because one or more of its delivery points is making use of Specific ST Lines and therefore this charge should be included.

b. The Performance and Benchmarking Working Group raised concern that in circumstances where a shared LV line spans sparsely populated areas of Hydro One's service area, the inclusion of 100% of the "Shared LV Line" costs in the embedded distributor's benchmarking costs may unfairly overstate the LV costs for that distributor.

   How might the Board identify these circumstances and only allocate "Shared LV Line" costs in proportion to the "Shared LV Line" that is in the embedded distributor's service territory?

   Customer density does not affect ST charges. The ST costs that Hydro One charges to embedded distributors reflect the costs incurred in conveying electricity from the transmission system to its distribution system. The types of ST charges levied to an individual distributor reflect the connection configuration of that distributor (i.e., it

pays a particular ST charge, such as specific ST Lines charge or an LVDS charge, only if it makes use of those types of ST facilities).

The distributor pays its <u>proportionate</u> share of the cost for the line (both outside and inside their territory), as costs were incurred to construct that line in order to connect that distributor to the transmission system. If that option was not available, the distributor would have to invest in its own assets to connect directly to the transmission system over the same distance. More generically, the inclusion of ST costs for all distributors in this assessment would provide a "proxy" for the total "distribution" related costs (both the distributor's costs and the upstream host's distribution costs associated with connecting that distributor to the transmission system) for supplying its customers from the transmission system.

<u>Efficiency Cohorts/Rankings & Stretch Factors</u>

10. For each expert's recommended approach:
    a. Is the proposed approach appropriate? Does it meet the Board's policy direction noted above?

    Hydro One concurs with the PWU and PSE reports. Hydro One believes that further research into industry best practices from external sources is required.

    b. What is your preferred approach and why?

    See "a" above.

11. What are appropriate stretch factor values? Why?

    Based on the evidence submitted in the various papers it would not be possible to derive an objective appropriate value for stretch factors. The criticisms in the other papers on PEG's quality and quantity of research, coupled with the other experts' proposed inflation and productivity factors, would suggest that these differences should be reconciled prior to setting stretch factors.

<u>Implementation Considerations</u>

12. What indicators should the Board consider monitoring on an on-going basis to test the reasonableness of the results of its PCI formula before it is applied to adjust the distributor's rates (i.e., ex ante)?

    The use of the Board's proposed Performance Scorecard would provide the support necessary for informed decisions and appropriate actions. This would also ensure that cost efficiencies are not being attained at the expense of customer service or the safety of the public and the distributors' workers, and would reflect past Board positions.

13. When the Board updates the industry productivity factor every five years, should the new productivity factor be automatically applied to all distributors that are then on 4th Generation IR? Why or why not?

The new productivity factor should only be applied on re-basing years.

General

14. With respect to your preferred approaches, as identified in your answers to prior questions, what other implementation matters, if any, need to be considered by the Board?

Safety, reliability, performance and customer service drive costs and determine culture in the electricity distribution environment. As part of this implementation, the Board may consider methods for the collection of consistent data to allow future inclusion of these factors into any new or revised GIRM.