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VIA RESS FILING and COURIER

Ms. Kirstin Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto, Ontario M4P 1E4

Dear Ms. Walli:

Re: EB-2013-0416 re 2015-2019 Distribution Rate Application
Submissions of the Power Workers' Union

Attached please find the Power Workers' Union's Submissions in connection with the above-noted proceedings. An electronic copy has been filed through the Board's RESS filing system, and two paper copies will follow by courier delivery.

Yours very truly,
PALIARE ROLAND ROSENBERG ROTHSTEIN LLP

Richard P. Stephenson
RPS:pb

Encl.

Doc 1268604 v1

EB-2013-0416

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 approving just and reasonable rates and other charges for electricity distribution to be effective January 1, 2015, each year to December 31, 2019.

Submissions of the Power Workers' Union

1. The following are the Power Workers' Union's ("PWU") submissions on the issues reviewed in the matter of Hydro One Networks Inc. ("Hydro One" or the "Applicant") 2015-2019 Distribution Rate Application (EB-2013-0416).

2. These submissions do not specifically address all issues on the issues list. Where an issue has not specifically been addressed, the PWU supports the application as filed, and adopts the submissions of Hydro One in support of the application.

A. CUSTOM APPLICATION

Issue 1.1: To what extent does the application reflect the objectives and approaches described in the RRFE Report?

3. The Ontario Energy Board's (OEB or "the Board") *Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach* ("RRFE"), issued on October 18, 2012, calls for distributors to focus on customer requirements and to demonstrate that their investment plans support cost-effective planning and operation of the distribution network. The RRFE consists of three main policies: rate-setting, planning, and measuring performance based on the principles of good asset management; coordinated long term planning; and measurable performance outcomes.

4. Under the RRFE, the Board established three rate-setting methods:[1]

- **4th Generation Incentive Rate-setting** ("4th Generation IR"): most appropriate for distributors that anticipate some incremental investment needs will arise during the plan term;
- **Annual IR Index**: distributors with relatively steady state investment needs (i.e., primarily sustainment); and
- **The Custom Incentive Rate-setting** ("Custom IR"): appropriate for distributors with significantly large multi-year or highly variable investment commitments with relatively certain timing and level of associated expenditures.

5. Hydro One is applying for a five year Custom Cost of Service application under the Board's new Custom Rate-setting method. Hydro One determined that a custom application is most appropriate, given its proposed significant and necessary multi-year investments with relatively certain timing and levels of associated expenditures.

6. The PWU notes that questions have been asked about whether Hydro One's application can be considered a Custom IR or a Cost of Service Application. Hydro One has been upfront that its application is a customized cost of service application – customized not only to reflect its own particular circumstances but also to respond to the requirements and expectations of the RRFE. As can be inferred from the wordings of Issue 1.1, the relevant consideration is the extent to which Hydro One's application responds to expectations of the RRFE relating to the Custom IR rate setting method. In this regard, the PWU agrees with Hydro One that its custom cost of service application, while not based on a formulaic index, is in the same category as Custom IR:

> **MS. FRANK: That's correct. We thought it is important that we clarify -- when you talk about incentive regulation it is often seen as formulaic in nature. So it's an inflation minus productivity or some type of a formula.**
>
> **And we wanted to be perfectly clear that our application is a bottom-up assessment of costs over the five-year period. That's why we called it the custom cost of service. Not to allow there to be any confusion that it is bottom-up costing**

[1] Report of the Board - Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach, Page 14

rather than formulaic.

MR. RUBENSTEIN: You would believe that it is the same category, the custom IR and your title of it? The custom cost-of-service application?

MS. FRANK: Yes, I would.

7. In addressing the issue of to what extent Hydro One's Application reflects the objectives and approaches described in the RRFE Report, therefore, it is important to first recognize that distributors that choose the Custom IR approach are allowed, and in fact expected, to customize their application to reflect their particular circumstances. The specifics of such matters as rate recovery, performance monitoring over the term of the plan, and the recognition of productivity savings as outlined in the RRFE, should be up to the individual distributor to determine:[2]

> **In the Custom IR method, rates are set based on a five year forecast of a distributor's revenue requirement and sales volumes. This Report provides the general policy direction for this rate-setting method, but the Board expects that the specifics of how the costs approved by the Board will be recovered through rates over the term will be determined in individual rate applications. This rate-setting method is intended to be customized to fit the specific applicant's circumstances. Consequently, the exact nature of the rate order that will result may vary from distributor to distributor.**

8. Secondly, it has to be recognized that the Board, notwithstanding its effort to articulate the objectives and approaches that distributors choosing the Custom IR have to satisfy, the RRFE Report leaves the details and the manner by which these objectives and approaches are satisfied to be addressed on a case-by-case basis. This is understandable in that there is no way for the Board to have prescribed specific measures, targets, and approaches that are fit to each and every distributor's specific circumstances. This is also understandable given that this is the first time that the Board, the Applicant and stakeholders are dealing with Custom IR. The Board, the Applicant and stakeholders are all just beginning to learn and understand the challenges of implementing the Custom IR approach in practice. Experience indicates that even in cases where there has been some experience, incentive regulation is a

[2] Report of the Board - Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach, Pages 18-19

learning process. A good example is the Board's recent Report titled: *New Policy Options for the Funding of Capital Investments: The Advanced Capital Module* (EB-2014-0219), which the Board believes is an improvement on the Incremental Capital Module approach.

9. Third, as can been seen from Table 1 below, the PWU submits that Hydro One has substantially included or satisfied the elements of the Custom IR rate setting method provided in the RRFE with the exception of Custom Index and some numeric productivity factor.

Table 1: Elements of the three rate-setting methods[3]

		4th Generation IR	Custom IR	Annual IR Index
Setting of Rates				
"Going in" Rates		Determined in single forward test-year cost of service review	Determined in multi-year application review	No cost of service review, existing rates adjusted by the Annual Adjustment Mechanism
Form		Price Cap Index	Custom Index	Price Cap Index
Coverage		Comprehensive (i.e., Capital and OM&A)		
Annual Adjustment Mechanism	Inflation	Composite Index	Distributor-specific rate trend for the plan term to be determined by the Board, informed by: (1) the distributor's forecasts (revenue and costs, inflation, productivity); (2) the Board's inflation and productivity analyses; and (3) benchmarking to assess the reasonableness of the distributor's forecasts	Composite Index
	Productivity	Peer Group X-factors comprised of: (1) Industry TFP growth potential; and (2) a stretch factor		Based on 4th Generation IR X-factors
Role of Benchmarking		To assess reasonableness of distributor cost forecasts and to assign stretch factor		n/a
Sharing of Benefits		Productivity factor		
		Stretch factor	Case-by-case	Highest 4th Generation IR stretch factor
Term		5 years (rebasing plus 4 years).	Minimum term of 5 years.	No fixed term.
Incremental Capital Module		On application	N/A	N/A
Treatment of Unforeseen Events		The Board's policies in relation to the treatment of unforeseen events, as set out in its July 14, 2008 EB-2007-0673 Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, will continue under all three menu options.		
Deferral and Variance		Status quo	Status quo, plus as needed to track capital spending against plan	Disposition limited to Group 1 Separate application for Group 2
Performance Reporting and Monitoring		A regulatory review may be initiated if a distributor's annual reports show performance outside of the ±300 basis points earnings dead band or if performance erodes to unacceptable levels.		

10. Hydro One has explained why it felt a bottom-up assessment of its costs over a five-year period and the recognition of productivity savings in its forecasts of costs and revenue is more appropriate than proposing formulaic numbers:[4] [5]

> **MR. RUBENSTEIN: For custom IR it says "custom index". Am I correct there is no custom index, or you have not set an index. I think that was what you were telling me with respect to why you call it a custom.**

[3] *Ibid.*, Page 13
[4] Oral Hearing Transcript, Volume 1, Pages 29-30
[5] Oral Hearing Transcript, Volume 1, Pages 80-81

MS. FRANK: Ours is a bottom-up determination of costs, yes.

.....

MS. LEA: ....And I was wondering why you did not propose a custom index, based on your forecasts; in other words, derive or come up with an index based on the forecast that you have provided in your cost-of-service application.

MS. FRANK: It would have been possible to overlay the productivity that we have built in and the savings with a formulaic-type number.

We see -- we saw no benefit of doing that. Our value, we thought, was actually in reducing the costs and reducing the revenue requirement and asking the customers to have a less of a rate impact.

So the productivity really went to, are the customers seeing a lower rate request because you have productivity, because you have some savings in your plan, but actually making it into a formula, we thought the custom allowed you to take different methods. So we didn't think it required you to put a formula on it, and we haven't.

MS. LEA: So despite the indication in the row labelled "sharing of benefits" that custom IR is to include a productivity factor, rather than do that, you have chosen to factor savings into your forecast costs?

MS. FRANK: Productivity factor, to me, is a broad term. I see that as including areas of being more efficient, being more productive.

So do you have any productivity built into your application? Is that factor included? And I would say, yes, that factor is included.

I did not read this to be so narrow as to say you had needed a number.

MS. LEA: And do you equate productivity with cost efficiency and cost savings?

MS. FRANK: Yes, I do.

11. The PWU submits that even though Hydro One's Application does not include a Custom Index or a productivity factor, productivity gains in the form of projected cost savings are built into Hydro One's investment plans. Moreover, it would be erroneous to assume that Hydro One's customized cost of service application does not advance the interests of the rate payer or would prevent the Board from protecting the interest of the rate payer because, even under the traditional cost of service application, the Board can always scrutinize all cost forecasts and the assumptions underpinning the forecasts. In fact, the PWU submits, the Board is afforded better opportunity to scrutinize evidence when all cost forecasts and assumptions are made available to it than when assessing

the reasonableness of proposed custom index that might have been developed using questionable assumptions and unreliable data.

12. Hydro One has done its utmost with respect to all the other remaining elements listed in Table 1 above. Hydro One's customized cost of service application, while customized to reflect the specific needs of the company, responds substantially to the requirements of an incentive-based rate setting (and the Custom IR) including the recognition of customer preference, the use of benchmarking to the extent that it is doable and cost effective, the inclusion of rate smoothing mechanisms, the recognition of risks, and various forms of incentive mechanisms described below:

13. First, as noted by PEG,[6] longer plan terms, such as Hydro One's 5-year plan term, strengthen performance incentives and are especially useful in encouraging initiatives that involve up-front costs to achieve long-run efficiency gains. Subject to some proposed adjustments, Hydro One's application is fixed over the 5-year rate term. In other words, whatever rates are approved by the Board, they will be locked in for the duration of the test years. Hydro One is, therefore, greatly incented to manage its costs, meet the embedded productivity targets and the eight performance metric targets, and complete its planned work program within the budget reflected in the revenue requirement. As the PWU pointed out during cross examination, in terms of the risks and incentives that arise from fixed revenue requirements or locked rates over a 5-year period, the impact is exactly the same as in the case of a traditional IRM:[7]

> **MS. FRANK: I would agree with the theory.**
>
> **MR. STEPHENSON: Okay. There is an intrinsic risk with traditional IRM that the Board has identified, and I think you and I have heard about it all the time, which is that in the quest to reduce costs and therefore obtain the economic benefit that can come from IRM there is a risk that a utility will -- won't spend enough, and there is a risk of degradation of service and reliability. That is a concern that has been identified. Correct?**
>
> **MS. FRANK: Yes, I would agree with that.**
>
> **MR. STEPHENSON: And people have talked about various ways by which that risk can be managed, and whether it is through standards or the potential for rewards**

[6] PEG, Defining, Measuring and Evaluating the Performance of Ontario Electricity Networks: A Concept Paper Report to the Ontario Energy Board, April 2011, Pages 11-12
[7] Oral Hearing Transcript, Volume 2, Pages 5-9

and penalties, that is all addressed to that risk. Correct?

MS. FRANK: I think that's why we have performance outcomes and measurement, in terms of service quality.

MR. STEPHENSON: Right. Now I want to talk about your application. The difference between your application and the, you know, second-generation IRM or whatever is that under your -- leaving aside the fact it is for five years instead of two or three, but under your scheme or proposal, the go-forward rates are not determined on a formulaic basis. They're determined on a forecast cost basis. Correct?

MS. FRANK: That's correct.

MR. STEPHENSON: But let's assume, just to simplify things here, that your -- the Board grants your application as asked, okay? It's an assumption I am sure you are happy to take. The moment that happens -- that is, the Board grants the application -- I'm going to suggest to you that the effect of that is exactly the same as if the Board had granted a five-year IRM in the sort of second-generation flavour of it, in the sense that, as of the moment the application is granted, your rates are locked in for the duration.

MS. FRANK: I'm hesitating because of the annual adjustment mechanism. That aside -- that aside –

MR. STEPHENSON: You would agree with me under both schemes there are a variety of annual adjustments and off-ramps and so forth? That is a common feature? The precise details may be different, but it is, broadly speaking, a common feature; fair?

MS. FRANK: That's fair.

MR. STEPHENSON: Okay. So leaving that matter aside, which is common, in both cases you're effectively locked in for the duration; correct?

MS. FRANK: That's correct.

MR. STEPHENSON: Okay. So I'm going to suggest to you, from that moment going forward -- that is from the approval of the rates -- the incentive for Hydro One and the risks for the system are exactly the same, regardless of what the precise mechanism that led to the locking-in of those rates.

MS. FRANK: I will agree with that.

MR. STEPHENSON: And the reason that the incentives are precisely the same is that for the five-year duration, your rates are completely de-linked from your actual costs. Again, subject to these adjustments.

MS. FRANK: Yes.

MR. STEPHENSON: And so if, under IRM, you have an incentive to reduce costs because you can, in effect, keep the earnings, you have exactly the same incentive and exactly the same extent of that incentive under your proposed scheme.

MS. FRANK: Yes.

MR. STEPHENSON: And I'm going to -- let me just use an example here. And I am going to come back to this when I deal with the panel about compensation.

So you're coming up to a round of collective bargaining with my client, the Power Workers Union, next spring. In fact, starting soon, but the collective agreement expires next spring; correct?

MS. FRANK: That's correct.

MR. STEPHENSON: Okay. And you've embedded in your application a forecast with respect to compensation cost escalation over the period of your application; correct?

MS. FRANK: Yes, we have.

MR. STEPHENSON: Okay. Again, let's, for the purposes of this conversation, assume that the Board grants your application as asked.

Isn't the effect of your application that you will be, the company will be, under a ferocious incentive to meet or beat the forecast that you have embedded in your application in terms of that collective bargaining?

MS. FRANK: I don't know about your modifier. Certainly it's -- the company would feel very obligated to stay within our forecast and look for opportunities to do better so that we could actually increase our work program.

MR. STEPHENSON: Well, but let's leave aside, you know, all the niceties here. If you -- if you beat the forecast in collective bargaining, the company keeps the difference. I mean, they can deploy it as they see fit, but in theory it goes straight into the shareholder's pocket; correct?

MS. FRANK: That would not be our intention.

MR. STEPHENSON: It would be an available option?

MS. FRANK: It would be an option.

MR. STEPHENSON: Okay. Similarly, if you don't beat the forecast, if you do worse than the forecast, that comes straight out of -- it either comes out of the shareholder's hide, or you've got to accommodate it somewhere else. Right?

MS. FRANK: That's true.

MR. STEPHENSON: And so you will be facing a very significant economic, direct and significant economic forecast in those negotiations, as I say, to meet or beat your forecast? There is a real tangible win/loss directly for the company; correct?

MS. FRANK: Yes, I will accept that.

MR. STEPHENSON: And that's just an example. That, the same basic thesis, will be true whenever the company has -- is engaging in any cost exercise. To the extent you can meet or beat the forecast, you're great and economically advantaged, and to the extent you do worse than the forecast, that's going to create a serious challenge for the company; fair?

MS. FRANK: Yes.

MR. STEPHENSON: And you'd agree with me that is a tangible economic and financial incentive for the company go-forward once the application is granted?

MS. FRANK: Incentive or disincentive, yes.

MR. STEPHENSON: Well, let's put it this way. You have an enormous incentive not to do poorly and an enormous incentive to do well; fair?

MS. FRANK: Okay.

14. Secondly, embedded in Hydro One's forecast expenditures are projected productivity savings. The PWU agrees with Hydro One that these projected productivity savings serve as targets because the risk of failing to meet them is borne by Hydro One and its shareholder, for example, in the form of lower return on equity. Naturally, Hydro One is incented to achieve these projected efficiency gains. A good example would be Hydro One's projection of lower wage increases to be achieved from collective agreements and productivity savings from outsourcing contracts both of which involve significant risks that the forecast savings may not be achieved. However, under Hydro One's application, the rate payers are guaranteed the benefit of these savings in rates, regardless of whether the savings are actually realized.

15. Thirdly, Hydro One put substantial effort to determine customer needs and measure customer satisfaction and reflect the results in its investment plans and cost proposals. The best evidence that shows the priority given to customer preference, which is primarily concerned with electricity price/rate, is Hydro One's decision to maintain a fourth quarter reliability level as the goal of its investment plans.[8] Moreover, Hydro One has proposed a rate-smoothing approach that will mitigate the impact on customers in the early period and encourage the company to find ways to manage the impact, in the near term, of a reduction in coverage ratios for debt issues.

16. Finally, Hydro One has not only proposed a set of outcome measures to track its performance and delivery of the plan, but also has proposed a number of adjustment mechanisms in the design of its custom application.

[8] Obviously, a case could be made for moving to a higher quartile. However, the cost and rate impact of doing so would be very significant.

17. The PWU, therefore, submits that Hydro One's proposed custom application framework is consistent with the Board's RRFE requirements and specifically with the Custom IR.

18. In the context of all of the above, the PWU finds Board Staff's comment and recommendations on this issue largely unreasonable. In the following section, the PWU responds to Board Staff's comments and recommendations to the Board.

a. PWU's Comments on Board Staff's Submission

19. Board Staff fails to recognize that fundamental to Hydro One's application is the premise that while its application does not exactly conform to every single element of the Custom IR rate setting method, it conforms with the Custom IR substantially, and more importantly is consistent with the RRFE's values and desired outcomes. Board Staff implicitly rejects Hydro One's premise that its application meets the values and desired outcomes of the RRFE. What Board Staff has focused on is consistency with the form and methodology of the other two rate setting methods – Annual IR Index and 4th Generation IR, rather than values and outcomes of the RRFE.

20. As the chart describing the elements of the three rate-setting methods in the RRFE Report cited in this submission earlier indicates, the Board is not as prescriptive with the Custom IR rate setting method as it is with the other two methods. For example, with regard to the Sharing of Benefits, the Board is clear that productivity factor and stretch factor would be applied in the case of Annual IR Index and 4th Generation IR. In the case of Custom IR, productivity factor is one consideration but the Board does not prescribe that a stretch factor would be used. The Board is expected to assess this requirement on a 'case by case' basis. With respect to other elements such as annual adjustment mechanisms and productivity, etc., the RRFE report similarly states that the Board would apply such tools as the distributor's own rate trend for the plan term determined by the Board and informed by the distributor's forecasts (revenue and costs, inflation, productivity, etc.) and the Board's own inflation and benchmarking to assess the reasonableness of the distributor's forecasts.

21. Board Staff chooses not to recognize that Hydro One's application should be assessed in terms of "the extent to which its application is consistent with the RRFE" and unreasonably devalues all the elements of Hydro One's application that make it a custom costs of service application into which many incentive-based mechanisms are built. In its submission, for example, Board Staff describes Hydro One's application simply as a 5-year cost of service, rate of return application.[9] On the other hand, Board Staff acknowledges that Hydro One built "planned cost reductions into cost forecasts"; this, however, it does without accepting that these planned cost reductions amount to productivity savings.

22. Board Staff states that it disagrees with Hydro One's position that cost efficiency and cost savings amount to productivity because "productivity is more than just cost savings."[10] To support its argument, Board Staff makes a reference to the final report of the Pacific Economics Group ("PEG") Research released on November 21, 2013 and entitled "Empirical Research in Support of Incentive Rate Setting in Ontario", in which productivity is explained as a "measure of the extent to which firms convert inputs into outputs. Comparisons can be made between firms at a point in time or for the same firm (or group of firms) at different points in time."[11]

23. The PWU does not question PEG's definition of productivity. Productivity can be used to compare the performance of firms at a point in time or to compare the performance of a firm against itself over time. This performance is measured by assessing whether a firm has managed to increase output (goods and services) for a given quantity of input (labour, material etc.) or reduce the quantity of input used to produce a given quantity of output. In this regard, it is not clear why Board Staff does not consider cost reductions (for projected work programs/output) proposed by Hydro One as a measure of productivity given that costs are nothing but monetary expressions of inputs. In the PWU's view Board Staff fails to recognize the linkage between cost savings and productivity gains; i.e. the extent to which changes in productivity are reflected in cost savings. A good example that demonstrates this relationship between

[9] Board Staff Submission, October 7, 2014, Page 4
[10] *Ibid.*, Page 9
[11] *Ibid.*, Page 10

productivity and costs savings is the introduction of the "feller-bunchers" which, according to Hydro One's evidence, has improved productivity; i.e. amount of labour per unit of output is reduced from 0.8 hours per tree to 0.16 hours per tree.[12] Hydro One's evidence also shows that Hydro One was able to save $40 per tree due to this increased productivity.[13]

24. It is clear, therefore, that Hydro One's plan proposes productivity improvements by virtue of the fact that the plan assumes Hydro One will strive to achieve the significant costs savings projected in the Application, while maintaining or increasing the levels of achievement. The fact that Hydro One has not filed an external productivity benchmark does not mean that projected cost reductions/savings included in Hydro One's plan do not constitute productivity gains. It is also important to note, as Board Staff points out, that the Board's productivity factor is currently set at zero and will only be updated in 2019. Hydro One is delivering tangible productivity improvements at a time when IRM filers are simply expected to maintain status quo productivity.

25. In the context of all of the above, the PWU submits that Board Staff's recommendation of a 1 per cent per year stretch factor is unreasonable. This is nothing more nor less than an arbitrary disallowance from the proposed revenue requirement, without any evidence of a lack of prudence whatsoever. As indicated earlier, Hydro One's application is a customized cost of service application in which the Board is presented with cost and revenue forecasts that assume aggressive productivity savings. Board Staff is not asking the Board to impose a stretch factor on a formulaic productivity adjustment, in circumstances where the Board has no evidence of forecasts of actual cost. This application provides the Board with that evidence and with evidence of the incentive outcomes embedded into the application that a stretch factor is intended to achieve.

26. The PWU submits that the stretch factor is implicitly embedded in Hydro One's proposed cost forecasts for the 2015-2019 test years. The stretch factor in this case is essentially the difference between the zero productivity factor that the Board has

[12] Exhibit A, Tab 19, Schedule 1, Page 2
[13] Exhibit A, Tab 19, Schedule 1, Page 2

determined and the actual cost reductions that Hydro One is proposing. As articulated in the RRFE Report, the stretch factor component of the X-factor is intended to reflect the incremental productivity gains that distributors are expected to achieve under IR and is a common feature of IR plans.[14] This very issue has been addressed in Undertaking J4.2 which showed that the reduction in Hydro One's revenue requirement for the test years resulting from Hydro One's cumulative incremental cost savings equals the reduction in revenue requirement that would result if the Board approved a Stretch Factor of 0.79.[15] This stretch factor is clearly higher than the 0.6 stretch factor that PEG's latest benchmarking update assigned to Hydro One. Board Staff's recommendation would amount to an impermissible double-dip on reductions to Hydro One's revenue requirement.

27. Board Staff also seems to suggest that without a benchmarking study[16] the Board simply cannot assess the reasonableness of a utility's proposed costs. Board Staff states that in the absence of benchmarking evidence, "the Board must rely on the company's word to determine whether its forecasts are reasonable."[17] Implicit in this submission is the assertion that benchmarking is the sole tool available to the Board to assess the reasonableness of forecasts. This is neither true, nor consistent with the Board's long history of scrupulous examination of utility cost of service applications. It would be an abdication of the Board's responsibilities to "take the company's word for it". The entire purpose of cost of service rate applications is to permit the Board, through various means, to test the applicant's evidence and satisfy itself as to the quality of the evidence presented.[18]

28. The Board has every right to examine the proposed costs and to make determinations as to whether they are reasonable or not reasonable. However, in the absence of a finding that the proposed costs are not reasonable, the imposition of a

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[14] OEB. Report of the Board - Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach, October 18, 2012, Page 17
[15] Undertaking J4.2
[16] Note that Hydro One has in fact filed a variety of benchmarking studies
[17] Board Staff Submission, Page 26
[18] While there is strong legal and factual basis for the use of a rebuttable presumption of prudence in relation to utility decision-making, this does not amount to "taking the company's word for it".

reduction to the proposed revenue requirement through the imposition of a stretch factor is simply unreasonable.

29. Nothing in the RRFE derogates from the Board's statutory obligation to set rates which are "just and reasonable" to both the utility and its customers. Rates will be just and reasonable to both the utility and its customers if those rates permit the utility the opportunity to recover its prudently incurred costs, but no more. While the *OEB Act, 1998* gives the Board considerable flexibility in determining rate setting methodology, whatever method the Board selects, it must give the utility *the opportunity* to recover the global amount of its costs. This precise issue was commented upon by the Divisional Court in *Advocacy Centre for Tenants-Ontario v. Ontario Energy Board*:

> **[59] Nor does our conclusion presume as to what methods or techniques may be available in determining "just and reasonable rates." Efficiency and equity considerations must be made. Rather, this is to say only that so long as the global amount of return to the utility based upon a "cost of service" analysis is achievable, then the rates/prices (and the methods and techniques to determine those rates/prices) to generate that global amount is a matter for the Board's discretion in its ultimate goal and responsibility of approving and fixing "just and reasonable rates."[19]**

Issue 1.3: What actions should the Board require Hydro One Distribution take at or near the end of the 5-year rate term (e.g. rebasing, plan assessment, measurement of customer satisfaction)?

30. The RRFE states that a distributor on the Custom IR method will have its rate base adjusted prospectively to reflect actual spend at the end of the term, when it commences a new rate-setting cycle. This is consistent with the Board's existing policies in relation to incremental capital under 3rd Generation IR.[20]

31. The PWU submits that, in accordance with the RRFE, Hydro One should adjust its rate base at the end of the term to reflect actual in-service capital additions made during the rate term and that this adjusted rate base should be used in the next rate-setting cycle. Rates are set prospectively. In accordance with the principle that rates are

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[19] *Advocacy Centre for Tenants-Ontario v. Ontario Energy Board*, 2008 CanLII 23487 (ON SCDC)
[20] Report of the Board :Renewed Regulatory Framework for Electricity: A Performance Approach, page 20

set prospectively, the Board should not require that Hydro One make adjustments during the 5-year term to reflect differences between actual spending and planned spending.

Issue 1.4: Is the proposed rate-smoothing mechanism appropriate? Given Hydro One's rate smoothing proposal, should the application include any other ratepayer protection measures such as an earnings sharing mechanism?

32. As discussed further later in this submission, Hydro One has done what it can to take into account customer needs and to minimize total bill impacts. The increases in the smoothed revenue requirement have a relatively small impact on the average customer's total bill: -1.5 per cent in 2015, 1.3 per cent in 2016, 0.8 per cent in 2017, 0.4 per cent in 2018 and 0.9 per cent in 2019. In fact, the impact on the average customer's total bill is less than the rate of inflation during the test years.

33. In the PWU's view, Hydro One's application is designed in such a way that the ratepayer is protected through a variety of mechanisms including the targeting of a fourth quartile reliability level, the inclusion of productivity savings in its cost forecasts, rate smoothing, and the proposal to make certain adjustments for unexpected outcomes over the course of the rate term. In this regard, the PWU is opposed to any additional earning sharing mechanism.

B. OUTCOMES AND INCENTIVES

Issue 2.1: Does Hydro One Distribution's Custom Application adequately consider customer feedback and preferences? Have customer feedback and preferences been adequately reflected in the OM&A and capital spending plans?

34. Hydro One's evidence indicates that Hydro One has put significant efforts to determine and measure customer needs and customer satisfaction through such tools as customer survey, the use of Customer Advisory Boards, Customer Focus Groups, and Stakeholder meetings and to reflect the results in the application. As indicated

under Issue 1.1, the best evidence to demonstrate that customer feedback and preferences have been adequately reflected in Hydro One's plans is that the plans are developed with the objective of meeting a fourth quarter reliability level. The PWU has concern that Hydro One's investment plan is designed to maintain a fourth quarter reliability level; however, the PWU also understands the significant rate impact that higher levels of investment could have on the ratepayer. In the PWU's view, however, this approach will not be sustainable in the long-term.

Issue 2.2: Does Hydro One Distribution's Custom Application promote and incent acceptable outcomes for existing and future customers (including, for example, cost control, system reliability, service quality, bill impacts)?

Issue 2.3: Does the Custom Application adequately incorporate and reflect the four outcomes identified in the RRFE Report: customer focus, operational effectiveness, public policy responsiveness and financial performance?

Issue 2.4: Is the monitoring and reporting of performance proposed by Hydro One Distribution adequate to demonstrate whether the planned outcomes are achieved?

35. The RRFE emphasizes the achievement of outcomes for customers. In response to the Board's new requirement, Hydro One has proposed eight outcome measures. As outlined by Hydro One the objective of the outcome measures is as follows:

> **These performance metrics are designed to measure the Company's success in delivering results (outcomes) over the course of the proposed five-year plan. Hydro One believes the forecast targets are achievable assuming normal levels of weather-related contingencies, significant events and customer driven requests. The outcome measures will be annually tracked and be reported to the Board.[21]**

36. Two groups of outcome metrics can be identified. A first set of outcome metrics is designed to measure major expenditures to be made over the 2015-2019 test years such as vegetation management, pole replacement, station refurbishment and distribution line equipment. A second set of outcome measures have a focus on

[21] Exhibit A, Tab 4, Schedule 4, Page 2

customer interest (customer experience, handling of unplanned outages, and estimated bills). In the PWU's view Hydro One's rate plan provides adequate outcomes for customers. Hydro One's evidence indicates that both the overall application and proposed outcome measures adequately align with customer preferences identified in the Voice of the Customer[22] and that the proposed outcome measures serve to support the four RRFE outcomes (i.e. customer focus, operational effectiveness, public policy responsiveness and financial performance).[23]

37. Rate affordability and reliability are factored into the proposed OM&A and capital budget levels. The proposed budget levels for vegetation management and major capital sustaining programs, while not at a level that permits to better meet business needs in term of the pace that is required to accelerate the replacement of the increasing number of assets reaching the end of their service life, strike a balance between Hydro One's business needs and rate affordability.

38. Outcome metrics for vegetation management, station refurbishment and distribution line equipment measure number of interruptions. With respect to pole replacement, the PWU acknowledges that pole replacement activity, i.e. number of poles replaced, cannot be strictly regarded as outcome. However, the PWU supports Hydro One's decision to give priority to measuring pole replacement activity and tracking pole replacement given the demography of its poles that calls for a ramped-up replacement. The PWU notes that due to the small number of outages related to defective poles, Hydro One sees that the use of the number of interruptions caused by defective poles is not an effective measure of outcome that should guide pole replacement plans.[24]

39. With respect to Reporting, the PWU recommends the use of the scorecard that Hydro One provided in Undertaking TCJ1.16 for annually tracking and reporting to the Board.[25]

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[22] Exhibit I, Tab 2.01, Schedule 1 Staff 4
[23] Exhibit I, Tab 2.03, Schedule 10 CCC 11
[24] Transcript, Technical Conference, July 21 2014, Page 61
[25] Exhibit TCJ1.16

C. PROGRAM AND PROJECT EXPENDITURES

Issue 3.1: Are the levels of planned operation, maintenance and administration expenditures for 2015-2019 appropriate, and is the rationale for the planning choices appropriate and adequately explained?

40. As can be seen from Table 2 below, the year-to-year total distribution OM&A spending proposed by Hydro One shows a decline or remains flat over the 5-year test period, but for the year 2016 - when spending increases by 8 per cent compared to the amount proposed for the previous year. The annual OM&A spending increases by an average of approximately 0.7 per cent during the 2015-2019 test period. This average annual increase represents less than half of the 2 per cent annual inflation rate assumed for the test period.

PWU Table 2 - Total Distribution OM&A Budget (in $ Million)*

	Bridge Year	Test years					Average 2015-2019
	2014	2015	2016	2017	2018	2019	
Total Distribution OM&A($M)	581.3	564.3	610.2	614.0	603.9	600.0	598.5
YoY Change		-2.9%	8.1%	0.6%	-1.6%	-0.6%	0.7%

*Total OM&A based on Exhibit C1, Tab 2, Schedule 1, Page 2, Table 1

41. Hydro One has submitted that the increase in OM&A is essentially found in the sustaining and operations budgets[26] and its evidence also indicates that the major contributor to the increase in sustaining OM&A is vegetation management.

42. By its nature, the cost of the OM&A program is driven by two broad factors: (a) the size and composition of the work program; and (b) the unit cost of the labour, materiel and other components used in the work program.

43. The PWU is not aware of any criticism of the OM&A programs, excluding the Vegetation Management Program, which the PWU will address below, on the basis that

[26] Hydro One Argument- in-Chief, Page 11

the size or composition of the work programs is inappropriate, or that the delivery of that program is inefficient or wasteful in any way. Similarly, the PWU is not aware of any criticism of the program arising from the unit costs for the inputs to the program – other than labour costs - an issue the PWU addresses under Issue 4.4. Materials are procured through a marketplace with a very rigorous procurement process. As such, the market prices at which materials are procured provide the basis for cost reasonableness.

44. The PWU anticipates that some parties may dispute the size and cost of the proposed Vegetation Management Program. Below is the PWU's comment on the Hydro One-proposed Vegetation Management Program:

a. Vegetation Management

45. Hydro One's evidence indicates that vegetation management expenditures will increase in 2016 and 2017 by about 25 per cent compared to expenditures proposed for 2015. Expenditures are projected to decline in the years 2018 and 2019 (see Table 3 below). The PWU also recognizes that the $814 million total expenditure proposed for vegetation management for the 5-year test period represents an increase of $146 million compared to the $668 million expenditures Hydro One spent on vegetation management during the preceding 2010-2014 period.[27]

PWU Table 3: Total Vegetation Management OM&A ($ million)*

Test years				
2015	2016	2017	2018	2019
142.0	177.6	180.3	161.1	152.9

*Based on data from Exhibit C1, Tab 2, Schedule 2, Table 10, Page 36

46. The PWU submits that the proposed expenditures are necessary because Hydro One needs to address the backlog of work needed to clear heavily and densely forested areas and overgrown right-of-ways. The need to address the backlog in turn arises from the fact that vegetation is the largest contributor to system outages and, consistent

[27] Undertaking J4.9

with the RRFE's expectation, Hydro One has a duty to improve, or at least maintain, customer satisfaction.

47. Hydro One's evidence indicates that Hydro One is targeting an 8-year clearing cycle which it believes will improve system reliability and reduce the life-cycle cost of managing vegetation over time.[28]

48. The length of the vegetation management cycle is an important objective in managing vegetation costs. Cycle length is the greatest single factor that leads to inefficiencies because the longer the cycle length, the more vegetation mass will accumulate, the more difficult the clearing work, and the higher the unit costs of doing the work. Thus cycle length is a key factor driving line clearing and brush control costs.

49. As the Board is aware, the *Hydro One 2009 Vegetation Management Benchmarking Study* filed in Proceeding EB-2009-0096 indicated that Hydro One had the longest average cycle length in the study at 10 years compared to most peers who operated on a 3 to 5 year cycle. The study noted that a 10-year cycle was on the fringe of acceptable vegetation management practice as it leads to inefficiencies due to the excessive vegetation growth between successive maintenance.[29] The PWU notes that in EB-2009-0096, Hydro One proposed a 7- year cycle for the 2010-2011 test years with the objective of improving vegetation management performance in the areas of cost per tree and unplanned activities and achieving a shorter cycle in line with peer utilities in the industry.

50. Unfortunately, as Hydro One's submission in the current proceeding indicates, subsequent to the Board's Decision in the EB-2009-0096, in which the Board reduced overall OM&A spending envelope by $40 million in both 2010 and 2011, Hydro One made a business decision to discontinue plans for a 7 year clearing cycle.[30]

51. Hydro One has submitted that despite its efforts in recent years to achieve a more optimum vegetation management cycle by tackling the rights-of-way beyond an 8

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[28] Exhibit I, Tab 3.01, Schedule 1 Staff 40, b)
[29] EB-2009-0096, Exhibit A-15-2, Attachment 1. Hydro One 2009 – Vegetation Management Benchmarking Study. CN Utility Consulting, Inc. September 18, 2009, Page 4
[30] Exhibit I, Tab 3.01,Schedule 1, Staff 40, b)

year cycle, the vegetation management spending has not been sufficient to keep pace with the increase in workload required to meet the 8-year cycle target. The evidence shows that over the last ten years Hydro One has not achieved the level of line clearing accomplishment required to sustain an 8-year line clearing cycle.[31] That level of accomplishment has led to backlogs and an increasing trend in line clearing and brush control unit costs. Not surprisingly, Hydro One's current clearing cycle is 9.5 years.[32] Moreover, Hydro One's evidence indicates that it has approximately 23 per cent of feeder kilometres beyond the eight-year cycle target.[33]

52. In assessing the reasonableness of Hydro One's proposed Vegetation Management Program, the Board should recognize that first, the proposed budget increases required to ramp up vegetation clearance during the test years will only enable Hydro One to maintain the current level of reliability and service quality for most of the test period. Hydro One is targeting to maintain 6,300 vegetation-related interruptions in 2014-2016 which is equivalent to the average number of vegetation related interruptions for the period 2009-2013. A modest decrease in the number of vegetation related interruptions are expected in 2018 and 2019.[34] Similarly, despite the proposed increase in expenditures, Hydro One will not be able to achieve the 8-year cycle target before 2023. As a result, customers will see significant reliability improvements beyond the test year period (i.e. in 2023) when all feeders will be on eight-year cycle.[35]

53. Secondly, while the proposed expenditures are expected to help bring the backlog under control by the end of the test period, they are not at a level that can reduce line clearing and brush control units costs during the test years except for 2018 and 2019 when they show a slight decline.[36]

54. Finally, the Board should recognize that, like all cost proposals in this application, rate impact was a key consideration in selecting the level of vegetation management

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[31] Undertaking J5.10
[32] *Ibid.*
[33] Exhibit D1, Tab 2, Schedule 1, Page 30
[34] Exhibit I, Tab 2.02, Schedule 3, PWU 2, a)
[35] Oral Hearing Transcript, Volume 4, Page 179
[36] Exhibit N0. PD1: Slide Presentation. May 12, 2014. Page 9

spending for the period 2015-2019. The selected 8-year cycle target limits the rate impact compared to one that would have resulted from a more aggressive vegetation management program under shorter cycle scenarios such as those recommended in EB-2009-0096.

55. In the PWU's view the proposed vegetation management budget, while not at a level that permits a fast-paced vegetation clearance that could result in improved reliability and reduced unit cost during the test period, strikes some balance between Hydro One's business needs and rate affordability. In the PWU's view, the proposed expenditures are the minimum that Hydro One needs to make.

56. Needless to say, a reduction in the proposed vegetation management budget for the 2015-2019 test period would result in lower reliability levels. Similarly, a disallowance of the proposed budgets would result in the perpetuation or worsening of the status quo – longer cycles, higher unit costs, and deteriorating reliability and service quality.

Issue 3.2: Is the level of planned capital expenditures appropriate for the period 2015-2019 and is the rationale for the planning and pacing choices appropriate and adequately explained?

57. Table 4 below shows that Hydro One's proposed capital expenditures for the test years represent a 1.4 per cent annual average increase. Table 4 also shows that the major driver of the increase in the proposed total capital expenditure is sustaining capital which increases at an annual average rate of 6.1 per cent over the 2015 to 2019 period.

PWU Table 4 - Total & Sustaining Distribution Capital Expenditures*

	Bridge Year	Test years					Average 2015-2019
	2014	2015	2016	2017	2018	2019	
Total Capital Expenditures ($M)	624.5	648.9	654.7	661.4	655.1	669.1	657.8
YoY Change		3.9%	0.9%	1.0%	-1.0%	2.1%	1.4%
Sustaining Capital ($M)	286.4	308.2	335.2	359.7	380.4	383.5	353.4
YoY Change		7.6%	8.8%	7.3%	5.8%	0.8%	6.1%

* Based on data from Exhibit D1, Tab 3, Schedule 1, Table 1

58. The PWU also notes that the pole replacement, stations and distribution line equipment capital sustaining programs represent about 67 per cent of total sustaining capital spending proposed for the 2015-2019 test period.[37]

59. The PWU submits that Hydro One's proposed capital expenditures are appropriate. Hydro One has provided in its evidence compelling reasons that support the planning and pacing choices underlying the proposed capital expenditures. Hydro One has provided extensive evidence describing its planning and investment prioritization processes that are applied to plan and pace investment levels associated with each OM&A and capital project/program.

60. The PWU notes that Board Staff, while does not suggest in its submission a specific reduction in capital spend, it states that large increases in pole and station spending "call into question Hydro One's prioritization process for asset management"[38]. The PWU submits that one main reason for the large increases thru the test period is the absence of larger increases over the past ten years. If Hydro One had been more aggressive about the need for asset replacement earlier, the ramp up of these expenditures would have been smoother. The PWU has been advocating such an

[37] Calculated from Exhibit D1-3-2, Tables 1, 2, and 5
[38] Board Staff Submission, Page 38

approach. The Board did not encourage more aggressive asset management. We are reaping today the seeds sown over the past decade or more.

61. Board Staff also acknowledges that a reduction of poles and stations spending would be "to some degree arbitrary";[39] however, it then proceeds to state that the stretch factor "should incent the company to find efficiencies in the work it has proposed to undertake."[40] The PWU submits that this simply demonstrates that Board Staff is proposing to use the "stretch factor" to accomplish a form of disallowance that the evidence does not actually support.

62. Hydro One has provided Investment Summary Documents ("ISDs") describing the rationales for investments in programs/projects in excess of $1 million.[41] An ISD for a specific program includes a description of the program along with an outline of the objectives and the needs of the program. As noted by Hydro One, the ISDs are developed at the stage of the investment prioritization process where the organization can make a decision on whether or not to proceed with a program or the scope of the program.[42] At this stage of the investment prioritization process the recommended investment alternative is contrasted, at least, against a "do-nothing" alternative. Also for such programs as the distribution station refurbishment program, for example, the ISD would include the "Individual Component Replacements" alternative.

63. Hydro One has also provided investment report summaries for major programs such as pole replacement, line clearing and distribution station refurbishment programs as illustrative examples. The investment report summaries are developed at the stage of the investment prioritization process where the organization decides on the level of the investment to be made. As outlined by Hydro One's witness during the oral hearing, the investment summary reports are prepared by planners and fed into the investment prioritization process in the following manner:[43]

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[39] *Ibid.*, Page 45
[40] *Ibid.*, Page 46
[41] Investment Summary for programs/projects in excess of $1 million are provided in Exhibit D2, Tab 2, Schedule 3
[42] Oral Hearing Transcript, Volume 5, Page 23
[43] Oral Hearing Transcript, Volume 4, Page 97

MR. BROWN: ...

The investment summary reports prepared by planners are fed into the investment prioritization process, which is facilitated by a piece of software called the Asset Investment Planning Tool.

The asset investment planning tool incorporates the business values and investment-level decisions -- sorry, definitions described in Exhibit A, tab 17, schedule 4.

Hydro One planners assign risk values and tolerances that they consider prudent within the tool. In Exhibit TCJ1.21 we have illustrated how the risk weightings work.

The asset investment planning tool then provides a draft investment plan which is reviewed and discussed by senior management when finalizing the priority and pacing of proposed investments.

64. In the following section, the PWU provides its comments on the pole replacement, station refurbishment and distribution line equipment capital sustaining programs.

a. Pole Replacement

65. Hydro One is proposing to spend approximately $530 million on the pole replacement program over 2015-2019 compared to the $320 million that Hydro One spent on the program during the preceding 5 years. The increase in the proposed spending is needed to meet Hydro One's plan of increasing the number of pole replacements from 11,000 in 2014 to 15,200 in 2019.[44]

66. The PWU understands that Hydro One's pole replacement strategy is twofold. First, the increase of pole replacements during the test years is driven by the demographic of poles and the need to manage the large volume of poles that are beyond expected service life ("ESL").[45] Second, by increasing pole replacements, Hydro One manages the risk of pole failures (i.e. the risk associated with the number of poles that fail Hydro One's asset condition test).

67. The PWU recognizes that Hydro One's proposed pole replacement plan represents a significant increase both in terms of the pace of pole replacement and the

[44] Exhibit A, Tab 4, Schedule 4, Pages 7- 8
[45] Exhibit I, Tab 2.04, Schedule 1, Staff 22

associated program budget. As discussed below, the reality is that the goal of replacing about 15,200 poles in 2019 will not result in a sustainable outcome to Hydro One's demographic and asset condition problems. The inescapable reality is that Hydro One faces increasing numbers of poles that are expected to be beyond ESL at the end of the 2015-2019 test period and beyond. Moreover Hydro One is expecting a higher number of pole failures in the next rate plan term due to the increasing trend in the number of poles beyond ESL.

i. Managing Pole Demography

68. Demography is a key input in projecting wood poles replacement requirements. Hydro One's evidence indicates that wood poles have an average ESL of approximately 62 years.[46] Currently there are about 180,000 wood poles exceeding their ESL, i.e. approximately 11 per cent of the total population of wood poles.[47] Hydro One expects 140,000 additional wood poles reaching ESL over the next five years.[48] Hydro One submitted that by increasing the pole replacement rate it will address premature decay and mitigate the risk of approaching a new wave of poles reaching ESL.

69. Hydro One has submitted that a sustainable level of pole replacement is about 25,000 or 26,000 poles per year:[49]

> **MR. BROWN: Yes. There's two things that -- you replace poles with a targeted pole replacement program, which I think we have talked about being sustainable around the 15,000 to 16,000 poles per year.**
>
> **That also relies on us through line renewal programs, joint use projects. Like, really a sustainable level of pole replacement is much higher than 15- or 16,000 poles per year. It's more like about 25,000 or 26,000 poles per year.**

70. As indicated earlier, Hydro One is planning to increase pole replacements from 11,000 poles in 2014 to 15,200 poles in 2019. In addition, Hydro One has stated that it has been replacing approximately 13,000 more poles per year on the distribution system through other work programs such as capital trouble calls and storm demand

[46] Oral Transcript, Volume 5, Page 46
[47] Exhibit I, Tab 3.02, Schedule 3 PWU 10
[48] Exhibit D1, Tab 2, Schedule 1, Page 20
[49] Oral Hearing Transcript, Volume 5, Page 42

response, upgrades driven by load growth, joint use and line relocations and line sustainment initiatives.[50]

71. A replacement level of about 25,000 poles coincides with the number of poles that would be required to be replaced each year if the demographic profile of the 1.6 million poles with an average survivability age of 62 years were uniformly distributed. However, Hydro One's pole population profile is not distributed uniformly:[51]

> **MR. STEPHENSON: Okay. Now the thing that I -- and certainly that's how the math works. If you divide 1.6 by 62 you get 25,000. And I'm assuming that that's essentially where that number comes from.**
>
> **MR. BROWN: That would be correct.**
>
> **MR. STEPHENSON: Okay. Now, embedded in that calculation is an assumption that you have a normal distribution of poles, in the sense that there's been an equal number installed historically over time, correct?**
>
> **MR. BROWN: That would be correct.**
>
> **MR. STEPHENSON: And that's not accurate, as a matter of fact, is it? There isn't an ordinary distribution of poles. Your poles have got a very specific demographic profile.**
>
> **MR. BROWN: Yes, and I believe it's included in the evidence that shows age demographics of our equipment.**
>
> **MR. STEPHENSON: Right. And as a practical matter, there were large numbers of poles that were installed during the period, say, from the mid-'50s until the late '70s or thereabouts, far more than average per year, correct?**
>
> **MR. BROWN: That would be correct.**
>
> **MR. STEPHENSON: And those are the very poles from a demographic perspective that are coming at you and are now reaching end of life, correct?**
>
> **MR. BROWN: That would be correct.**

72. As the PWU pointed out during cross examination, given that a large number of poles were installed from the mid-'50s until the late '70s, the number of poles reaching 62 years of ESL for the next 25 years is more than 25,000 per year.[52]

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[50] Exhibit I, Tab 2.02, Schedule 11, EP 13, a)
[51] Oral Hearing Transcript, Volume 5, Page 94
[52] Oral Hearing Transcript, Volume 5, Page 96

73. The evidence indicates that many of the 25,000 or 26,000 poles that are annually replaced do not reach their ESL of 62 year. About 7,000 out of the 13,000 that are not part of poles replacement program are within 10 years of end-of-life.[53] There are also about 3,000 red pine poles that are replaced every year as part of the pole replacement program.[54] Hydro One indicated that these 3,000 red pine replacements are below the 62 year of end-of-life.[55] Accordingly, Hydro One replaces only about 15,000 poles each year to manage the volume of poles beyond ESL.

74. The PWU submits that there is a very substantial mismatch between the 15,000 poles that are proposed to be replaced as part of the pole replacement program, and the number of poles that are expected to reach the 62 years end-of-life over the next 25 years. As a result of this mismatch, there will be a significant increase in poles reaching their ESL for many years to come, which will not be replaced, even under the higher targets being proposed by Hydro One. Under the proposed plan, Hydro One expects the number of poles beyond ESL to increase from 180,000 in 2014 to 266,400 in 2020, and further to 324,400 in 2030.[56] Under cross examination, Hydro One's witness agreed that the replacement of 15,000 poles per year is not sustainable.[57] The reality is that even the proposed 'ramping-up' of pole replacement to 15,000 poles per year in 2019 goes as planned, Hydro One will be worse off with respect to the number of poles beyond ESL by the end of the test period than it is today.

[53] Oral Hearing Transcript, Volume 5, Page 98
[54] Oral Hearing Transcript, Volume 5, Page 97
[55] Oral Hearing Transcript, Volume 5, Page 103
[56] Exhibit I, Tab 3.02, Schedule 3, PWU 10
[57] Oral Hearing Transcript, Volume 5, Page 105

ii. Managing Pole Failures

75. Hydro One is cognizant that the backlog of poles beyond ESL will continue to increase over the next years and therefore plans to manage the backlog by prioritizing pole replacements.[58] The PWU's understanding is that Hydro One prioritizes pole replacements by managing pole failures:[59]

> **MR. BROWN: So what we do is we manage the failures. And that's what -- so I guess what I would say right now, this is a very good model. It tells us on average what we expect to see going forward, and if we don't replace a significantly larger population of poles, we are going to see higher degrees of failure.**

76. In addition to the consideration of demography, Hydro One uses its asset condition assessment to replace poles. Hydro One has reported that about 50,000 poles have failed the hammer test and it expects that another 60,000 poles will be in that condition over the next five years.[60]

77. The indisputable fact is that there is a correlation between pole age and failures. As pointed out by the PWU during cross examination, more old poles mean more failures.[61] With the increase in the number of poles beyond ESL, Hydro One should expect an increase in the number of pole failures beyond the 2015-2019 test period. On the basis of this evidence, the PWU submits that Hydro One should be replacing poles on a more aggressive timetable, and that a more aggressive timetable is easily justifiable as reasonable. Nevertheless, the PWU recognizes the reality that rate pressures are such that there is no reasonable prospect that the Board will require a more aggressive pole replacement program. However, the PWU submits that Hydro One's proposal represents the absolute minimum that can be considered to be acceptable without (a) unreasonably jeopardizing system reliability; and (b) inappropriately shifting costs to future ratepayers.

78. In the context of all the above, it is submitted that the Board should approve the proposed expenditures as filed.

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[58] Exhibit I, Tab 2.02, Schedule 11, EP 13 b)
[59] Oral Hearing Transcript, Volume 5, Pages 40-41
[60] Oral Hearing Transcript, Volume 5, Page 41
[61] Oral Hearing Transcript, Volume 5, Page 103

b. Station Refurbishment

79. Hydro One is proposing to invest $203 million on its Distribution Station Refurbishment program over the test period to refurbish 194 distribution substations at an average replacement rate of about 39 stations per year. In the preceding 5 years, i.e., from 2010-2014, Hydro One spent only $46 million[62] and refurbished 52 stations.

PWU Table 5 - Number of Distribution Station Upgrades*

2010	2011	2012	2013	2014	2010-2014
2	2	3	13	32	52
2015	**2016**	**2017**	**2018**	**2019**	**2015-2019**
36	38	38	41	41	194

*Based on data from Exhibit I, Tab 3.03, Schedule 1 Staff 61

80. As can be seen from Table 5, distribution stations were refurbished at a replacement rate of about two stations per year for the period 2010 to 2012 and that refurbishment was ramped-up starting in 2013. In cross examination, Hydro One's witness attributed the low replacement rate in the past years to competing financial restrictions in terms of where the money was spent within the organization and other project priorities. Hydro One noted that the Cornerstone initiatives which provided a high long-term value put pressure on the funds available for other projects including the refurbishment of distribution stations.[63]

81. Despite the proposed budget increase and the ramp-up in the number of station refurbishments over the test period, the proposed level of capital investment in distribution stations will be sufficient only to maintain the current level of service reliability. Hydro One's plan is to meet a target of 155 substation-caused interruptions (excluding forced majeure and planned interruptions) during the 2015-2019 test period, a target that is equal to the average number of actual substation-caused interruptions during 2009 to 2013.[64]

[62] Exhibit A, Tab 4, Schedule 4, Page 10
[63] Oral Hearing Transcript, Volume 5, Pages 67-68
[64] Exhibit I, Tab 2.02, Schedule 3, PWU 2, a)

82. Hydro One's Investment Summary report for the Distribution Station Refurbishment program shows that the selected Alternative Spend (i.e. Asset Optimal – Modified) will enable Hydro One to maintain historic interruption hours (i.e. 50,000 to 200,000 interruption hours) over the 2014-2019 period whereas the other alternatives that propose a lower level of spending (i.e. Vulnerable, 1st Intermediate, 2nd Intermediate alternatives) will not be sufficient to maintain historic interruption hours.

83. Currently, about 19 per cent of the distribution substations exceed ESL. At the current replacement rate, Hydro One expects that about 31 per cent of the distribution substations will exceed ESL by 2020, whereas at the proposed replacement rate, 11 per cent of the distribution stations will exceed ESL by 2020.[65]

84. Hydro One's evidence also shows that approximately 27 per cent of its distribution stations are currently at high risk of failure. Hydro One's proposed plan will only help to keep the number of high risk stations at the current level - 27 per cent by 2020. At the current replacement rate, however, Hydro One expects that by 2020 the number of high risk stations will reach approximately 44 per cent of the distribution stations.[66]

85. The PWU submits that the proposed distribution station refurbishment plan will enable Hydro to properly manage the risk associated with demography and degraded asset conditions that are contributing to the operational risk of its distribution stations and therefore the Board should approve the proposed budgets.

c. Distribution Line Equipment

86. Hydro One is proposing to spend approximately $307 million on distribution line equipment projects over the 2015-2019 period compared to $156 million it spent in the preceding 5 years.[67]

87. Line equipment projects are comprised of Lines Sustainment Initiatives that involve the refurbishment or the replacement of entire feeders or feeder sections, the

[65] Exhibit I, Tab 3.02, Schedule 3, PWU 10
[66] Exhibit I, Tab 3.02, Schedule 3, PWU 6
[67] Undertaking J4.9

Line Component Replacements program and the Submarine Cable Replacements Program.

88. Hydro One has submitted that the replacement and refurbishment of line equipment that is close to reach its end-of-life ensures that equipment operates as designed and unplanned equipment outages are mitigated. Hydro One also notes that cost efficiencies are achieved by simultaneously replacing assets that are within the same vicinity.[68]

89. Line equipment is the second "likely most effective" focus area (next to Vegetation) in reducing the number and duration of customer interruptions.[69]

90. Like in the other areas of capital investment, the proposed level of capital investment in line equipment over the test year period is needed to maintain the current service reliability level. Hydro One targets 7,300 distribution line equipment-caused interruptions (excluding forced majeure and planned interruptions) for the 2015-2019 test period, which is equal to the average number of actual interruptions that occurred during the 2009 to 2013 period.[70]

91. For the above reasons, the PWU submits that Hydro One's proposed budgets should be approved.

Issue 3.3: Has Hydro One proposed sufficient, sustainable productivity improvements for the 2015-2019 period, and have those proposals been adequately supported, for example, by benchmarking?

92. As the PWU pointed out under Issue 1.1, Hydro One's evidence provides a detailed list of productivity initiatives along with the savings to be realized over the 2013-2019 period. Hydro One has submitted that productivity initiatives would result in cumulative savings for Distribution of $728.8 million for the bridge and test years.[71]

[68] Exhibit I, Tab 2.04, Schedule 1 Staff 27, c) i)
[69] Exhibit I, Tab 2.04, Schedule 1 Staff 27, a) and b)
[70] Exhibit I, Tab 2.02, Schedule 3, PWU 2, a)
[71] Exhibit A, Tab 19, Schedule 1, Table 2, Page 4

93. Productivity savings are reflected in projected reductions of OM&A or capital expenditures. Hydro One calculated cumulated incremental capital and OM&A savings of $184.5 million over the test year period taking 2014 as the base year.[72] Hydro One's evidence also shows that without OM&A productivity savings, Hydro One's revenue requirement would increase by about 17/18 per cent over the test years.[73]

94. Also, as demonstrated in Undertaking J4.2 cited earlier, the reduction in revenue requirement over the test years arising from Hydro One's cumulative cost savings would be equal to that which would result if the Board approved a Stretch Factor of 0.79%.

D. COMMON COSTS AND PROCESSES SHARED BY HYDRO ONE NETWORKS' TRANSMISSION AND DISTRIBUTION BUSINESSES

Issue 4.4: Is the compensation strategy for 2015-2019 appropriate and does it result in reasonable compensation costs?

95. In general terms, compensation costs at Hydro One are determined by the number of employees and the actual payments (compensation levels) made to employees. In turn, these two inputs are a function of a number of other considerations, such as volume or scope of work programs, a predominantly unionized work environment, and a highly educated and highly skilled workforce that not only requires ongoing training but also merits compensation levels commensurate with the highly technical and diverse nature of Hydro One's integrated business operations.

96. Each of these considerations in turn is determined by a set of other factors. For example, a number of inputs go into collective agreements – an essential and foundational feature of a unionized work environment – including existing business, economic and labour market conditions and historical agreements that act as a basis for each new collective agreement. Most fundamental is the relative bargaining power of the union and management prevailing at the time the agreement is being negotiated.

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[72] Undertaking J2.3
[73] Exhibit I, Tab 2.01, Schedule 1 Staff 6

97. It is apparent that some of the factors which govern these costs are within the control of Hydro One, whereas others are not. In this regard, there are two issues the Board should consider when determining the reasonableness of compensation costs at Hydro One:

98. First, Hydro One's performance in controlling its compensation costs should be assessed relative to the inputs and costs that it can control and not against those over which it has little or no control.

99. Second, in assessing Hydro One's performance, the Board should give substantial weight to Hydro One's internal performance trends. It would be unrealistic and inappropriate to expect Hydro One to achieve significant savings through direct wage cuts or some drastic measures based on point-in-time comparisons of wage levels at Hydro One against wage levels in other "similar" companies, using a simple application of external cost comparators.

100. Evidence with respect to external comparators has been used in both the present and prior cases. The implicit, but fallacious premise of external comparators is that Hydro One is participating in the same labour market as external comparators. It is not. Such assumptions ignore the legal environment in which Hydro One operates. HO is not legally permitted to replace its existing workforce with employees currently employed by other employers, who are either non-represented, or represented by other trade unions. Hydro One must negotiate with its existing trade unions as the exclusive legal representatives of its employees.[74]

101. The collective agreements negotiated by other employers and their trade unions will reflect the complex of specific considerations which pertain to that employer and its unions, particularly the considerations which affect the relative bargaining power of each

[74] Hydro One's compensation costs would no doubt be different if Ontario labour legislation were different (e.g. "right to work"). However, the Board, like Hydro One, must accept the legal landscape (and its consequences) for what it is, not what it wishes it might be.

party. There is simply no basis in logic to assume that relationships which are governed by a different combination of inputs should generate comparable outputs.[75]

102. In light of the above, and the considerations that are further examined in the following sections, the PWU submits that there is no evidence before the Board that suggests Hydro One's complement and the compensation levels, and hence HO's proposed compensation costs, are not reasonable and prudent.

a. Employee Complement & Compensation

103. Employee complement is a matter over which Hydro One has a degree of managerial control. With respect to managerial non-regular and casual employees, Hydro One has a reasonably high degree of control over complement, subject always to having sufficient numbers to operate its integrated business in a safe and reliable fashion, and to perform planned and unplanned (storm driven) work programs. With respect to the PWU and the Society of Energy Professionals ("SEP") represented staff, Hydro One faces collective agreement restrictions on involuntary layoffs. This fact creates a significant limitation on control over unionized complement. However, Hydro One does have the managerial discretion to not refill vacancies created by retirements and other departures. As a result, attrition provides an opportunity for Hydro One to manage, restructure and transform its unionized complement over time.

104. For the period 2008 – 2013, the total Networks (Transmission and Distribution) work program is expected to increase by over 19.5 per cent whereas the increase in yearend employee complement is expected to increase by only approximately 10 per cent.[76] This represents a significant increase in labour efficiency. Hydro One's regular

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[75] No one suggests that it would be valid to benchmark Hydro One's compensation costs against utility workers in India or China. The reason is because the inputs in those jurisdictions are so different than are faced by Hydro One. However, the same logic applies with respect to domestic comparators. In a collective bargaining environment, the most critical factor affecting outcomes is the relative bargaining power of the employer and the union. There has been no examination of the comparability of this factor as between Hydro One and the putative comparators, and there is absolutely no basis to simply assume that they are similar.

[76] Exhibit C1, Tab 3, Schedule 1, Pages 5-6

complement is trending downwards with 2013 year end regular complement less than year end 2010 levels.[77]

105. For the period 2014-2019, the total Networks (Transmission and Distribution) work program is expected to decrease by approximately 4.9 percent while the regular employee complement is expected to decrease by 7.5 percent by year end 2019.[78]

106. The significance of these statistics is that Hydro One's resourcing strategy is trending towards a shift away (on a relative basis) from higher to lower cost labour sources. Hydro One's 2014-2019 business plan shows that regular employee complement will be reduced to 5,000 by 2019.[79] [80]

107. Hydro One has proactively dealt with the demographic challenge of its aging workforce by hiring staff in advance and allowing enough time for training and knowledge transfer to occur before the existing employee(s) retire. This ensures that Hydro One has a trained workforce with the necessary skill sets to run the operations safely and reliably. In recent years, there has been an increase in the full-time equivalent numbers but now the FTE is decreasing as employees retire.[81] The ratio of retirements to new hires is roughly two retirees for every one new hire.[82]

108. Hydro One tightly manages increases to regular employee complement and all requests for additional regular employees must be approved by the Chief Executive Officer.[83]

109. Hydro One's strategy is to utilize regular employee complement in the core business where specialized ongoing skills are required while using other flexible resourcing methods to perform work in indirect or support business functions which require less specialized skillsets.[84] Hydro One responds to opportunities created by attrition and utilizes a managed process to increase the proportion of staff who work

[77] Exhibit C1, Tab 3, Schedule 1, Pages 5-6
[78] Exhibit C1, Tab 3, Schedule 2, Page 10
[79] Exhibit C1, Tab 3, Schedule 1, Page 5
[80] Exhibit C1, Tab 3, Schedule 2, Attachment 2
[81] Oral Hearing Transcript, Volume 3, Pages 48-50
[82] Oral Hearing Transcript, Volume 3, Page 49
[83] Exhibit C1, Tab 3, Schedule 1, Page 5
[84] Exhibit I, Tab 1.01, Schedule 9 SEC 1, Attachment 1, Schedule A, Page 15

directly on projects and programs, while decreasing those in an indirect or support role. As a result, regular employee complement will decrease and the Company's long term financial burden will be reduced. This was confirmed by Hydro One's witness during cross examination by the SEP:[85]

> **MR. DUMKA: That's unfortunate. Anyway, so that is -- in 2012 we can see that there is roughly 5,400 regular staff and 300 temporary staff.**
>
> **If we flip to the last page of that attachment, page 5, and if we take a look, see the two numbers there, for regular staff they're roughly 5,000, and the temporary staff are roughly 900.**
>
> **So if we take a look at the period between 2012 and 2019, it seems apparent to me -- and I believe is in the compensation exhibits, et cetera -- where the company looks to be going is using more temporary staff and hiring a lower amount of regular staff.**
>
> **Would that be a fair assumption, based on the numbers that we see here, that is the intent?**
>
> **MR. STRUTHERS: Based on the charts that we provided to you, yes, that would be a fair assumption.**
>
> **MR. DUMKA: Okay. So overall, the per-unit cost of total regular and total temporary, if we adjusted for 2 percent per annum contract increases, we will see a per-unit decrease over that time frame, because we've got a higher proportion of temporary, as opposed to regular staff.**
>
> **MR. STRUTHERS: The weighted average would result in a lower rate -- total overall rate, yes.**

110. In order to complete the larger work program with fewer regular staff, Hydro One uses non-regular resources (Power Workers' Union Hiring Hall, temporary employees, Consultants/Contractors).[86] Hydro One's ability to utilize non-regular flexible resources to complete various work programs is possible due to the successful bargaining with the unions that produced new arrangements that both sides agreed to.

111. The PWU submits that Hydro One's staffing strategy is working: savings are being realized and the company is getting more work done for less money. The company's decision to focus on achieving overall cost reductions by negotiating increased management flexibility to run the operations, as opposed to direct reductions in compensation costs is a responsible strategy that avoids the risk of work stoppage

[85] Oral Hearing Transcript, Volume 3, Pages 146-147
[86] Exhibit C1, Tab 3, Schedule 1, Page 6

and unhealthy relationships between employees and management which in turn can negatively affect efficiency.

112. PWU represented staff form the majority of Hydro One's overall employees as well as the majority of Hydro One's overall compensation costs.[87] Hydro One's compensation costs are to a significant degree a function of the binding agreement with the PWU.

b. The Collective Agreements

113. Hydro One inherited collective agreements with the PWU, the SEP, the Canadian Union of Skilled Workers ("CUSW") and each of the 15 Building Trade Unions (via EPSCA) from Ontario Hydro in 1999 when it began operation which established terms of employment.[88]

114. Unionized employees at Hydro One make up approximately 90 per cent of Hydro One's work force.[89] Once a collective agreement is in place it is absolutely binding on the parties and items such as wages, pensions, and benefits can only be changed through the collective bargaining process; they cannot be changed unilaterally by Hydro One.

115. Subsequent collective agreements build on past agreements and changes can only occur where bargaining produces new arrangements that both sides agree to.

116. The current collective agreements[90] of Hydro One with the PWU and the SEP are effective until March 31, 2015 and March 31, 2016, respectively and the negotiating parties are legally bound by the agreements.[91]

117. The PWU wages increases provided under the current agreement are 2.5 per cent in each year. The cost increases were phased in on April 1 and October 1 in 2013 and 2014 to lessen cost impact.[92]

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[87] Oral Hearing Transcript, Volume 3, Page 31
[88] Exhibit C1, Tab 3, Schedule 2, Page 4
[89] Exhibit C1, Tab 3, Schedule 2, Page 4
[90] Exhibit C1, Tab 3, Schedule 2, Pages 7-8
[91] Unlike commercial contracts, collective agreements are not subject to "efficient breach", and are subject to specific enforcement by arbitrators and/or the Ontario Labour Relations Board.

118. The SEP wage increases provided under the current agreement are: April 1, 2013 - 2 per cent; April 1, 2014 - 2 per cent; and April 1, 2015 - 2.25 per cent.[93]

119. The compensation rates for PWU and SEP represented staff for the balance of the test period beginning April 1, 2015 and April 1, 2016, respectively will be determined by future collective bargaining.

120. Any attempt by Hydro One to achieve significant cost reductions in wages, benefits and pension payable to PWU-represented staff would likely result in a work stoppage.[94] As a result, Hydro One has instead sought to achieve overall cost reductions by negotiating increased management flexibility to run the operations, as opposed to wide scale reductions in wages, benefits and pensions.[95] This was discussed with Hydro One during cross-examination by the PWU:[96]

> **MR. STEPHENSON: And as I understand it, Hydro One, rather than beating its head against a wall in terms of trying to get an absolute decrease to wage rates, its focus has been to achieve things that give it flexibility in the management of the enterprise. That has been at least one of the big focuses. Is that fair?**
>
> **MR. STRUTHERS: Yes, that's a fair statement. We have been looking for additional flexibility in how we operate, yes.**
>
> **MR. STEPHENSON: And that results in lower cost overall, in terms of the operation of your business.**
>
> **MR. STRUTHERS: Yes, that's correct.**
>
> **MR. STEPHENSON: And your evidence, I think, has indicated a variety of ways that has occurred, but I just want to focus on one of them, and that is the PWU hiring hall.**
>
> **MR. STRUTHERS: Yes.**
>
> **MR. STEPHENSON: That was an innovation which was agreed to several rounds of bargaining in the past.**
>
> **MR. STRUTHERS: It's been very effective for us.**
>
> **MR. STEPHENSON: And it is something that you have, over time, used more and more of, I believe.**

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[92] Exhibit C1, Tab 3, Schedule 2, Page 7
[93] Exhibit C1, Tab 3, Schedule 2, Page 8
[94] Exhibit C1, Tab 3, Schedule 2, Page 5
[95] Exhibit C1, Tab 3, Schedule 2, Page 5
[96] Oral Hearing Transcript, Volume 3, Pages 45-47

MR. STRUTHERS: It is an effective way for us to get work accomplished, yes, very effective way.

MR. STEPHENSON: And the two key attributes to the hiring hall are -- there may be others, but one is that you are not undertaking any permanent commitments to the employees that are affected. They come and go as the work demands, correct?

MR. STRUTHERS: It allows us to have a seasonal work force, absolutely.

MR. STEPHENSON: And secondly, they -- they are not members of the Hydro One pension plan. You do not incur incremental pension obligations to those employees.

MR. STRUTHERS: That is correct. They are not part of the Hydro One pension plan.

MR. STEPHENSON: So I take it you view that as a -- that is a success story from your perspective.

MR. STRUTHERS: From a cost perspective and a flexibility perspective, it has been -- allowed us to get through the work program in a very cost-effective manner. It's been very effective.

121. Hydro One's performance in collective bargaining has been strong and Hydro One has been able to achieve incremental cost reductions and increased flexibility in a variety of areas in every round of collective bargaining since 2001.[97]

122. In 2011, Hydro One negotiated a 0.5 per cent increase to the PWU employee pension contributions and in the most recent negotiations, employee contributions have increased by a further 0.75 per cent in 2013 and 1.0 per cent in 2014. This represents a 56.25 per cent increase in the dollar value of employee contributions since 2011. The parties also agreed to the requirement to use mandatory generic prescribed drugs and to establish a joint committee to make recommendations to reduce costs in the area of biological and other expensive drugs.[98]

123. In 2013, Hydro One negotiated an increase to the SEP employee pension contributions: April 1, 2013 - 0.75 percent; April 1, 2014 - 1 per cent; and April 1, 2015 - 0.75 percent. Increased flexibility was also achieved in negotiations by increasing the

[97] Exhibit C1, Tab 3, Schedule 2, Pages 6-7
[98] Exhibit C1, Tab 3, Schedule 2, Page 7 In terms of the dollar amount of employee contributions, this amounts to increases in the following amounts: 2011: 12.5%; 2013: 16.66%; 2014: 19.04%

length of new hire probationary periods and formalizing the deletion of the Purchase Service Agreement so that contracting out can be fully utilized when appropriate.

124. In any round of collective bargaining the relative bargaining power of the two parties is the critical factor driving outcomes. Some of the factors that determine relative bargaining power are:[99]

- Employer's ability to threaten to take the work elsewhere, to simply shut down and move to another jurisdiction;
- Threat of insolvency;
- Employer's ability to replace people with technology;
- Employer's ability to offshore work; and
- Employer's ability to operate in the face of a work stoppage.

125. In the case of Hydro One, it has no ability to move its business elsewhere. It cannot make a credible threat of insolvency. It has a very limited ability to substitute technology for people. It has little or no ability to offshore work.[100]

126. According to Hydro One, the Company is unable to continue operations for a sustained period of time in the event of a PWU work stoppage due to the fact that there have been numerous downsizing programs, and reorganization of work, with fewer management staff available today with the requisite skills and experience to occupy key PWU positions during a strike.[101]

127. Even if Hydro One considered the option of a work stoppage, when dealing with a commodity that has a significant public impact, such as electricity, it is very unlikely that the Government would allow a lengthy work stoppage, and some form of arbitration would be mandated to resolve the dispute. The PWU notes that in terms of outcomes between collective agreements determined by the bargaining and the strike threat

[99] Oral Hearing Transcript, Volume 3, Pages 37-39
[100] Oral Hearing Transcript, Volume 3, Pages 37-39
[101] Exhibit C1, Tab 3, Schedule 2, Page 5

scenario versus collective agreements determined by interest arbitration, interest arbitration awards tend to be more generous to the workers.[102]

128. During the oral hearing it was noted that the benchmarking reports available in this proceeding and previous proceedings, however informative, do not influence the outcome in collective bargaining.[103]

129. The importance of performance relative to a relevant comparable comparator in the industry also plays a factor in collective bargaining:

> **MR. STRUTHERS: ...**
>
> **I should be a little more clear, in that I think within an industry certainly that parties will look to how other parties have performed in negotiations as sort of a reference point in terms of where they might want to try and achieve a number.**
>
> **MR. STEPHENSON: Right. And the way that manifests itself, in your world, is that people tend to look to the big electrical market players in Ontario, in your case particularly OPG and Bruce Power. Those are the big players, and some to a lesser degree, correct?**
>
> **MR. STRUTHERS: Yes. And I am sure that is how the Power Workers' Union looks at it as well, that they would look to what they have been able to achieve with OPG and Bruce Power.**
>
> **MR. STEPHENSON: And the reason why those people are particularly relevant is not only just their size and the fact that they're in Ontario, but they came from a common starting point. Everybody in 1998 had exactly the same deal. Correct?**
>
> **MR. STRUTHERS: That's correct. It's an easy way to measure yourself.**[104]

130. In considering the prudence of Hydro One's compensation costs arising from a collective agreement, the Board must recognize that, once the collective agreement has been entered into, Hydro One is legally obliged to pay the costs that arise out of that collective agreement. The sole exception to this is if the Board finds, as a fact, that through the exercise of management discretion, Hydro One is able to reduce or avoid some aspect of the costs payable under the agreement. In the case of the current agreements, the only such possibility would be for Hydro One to reduce complement through non-replacement of voluntary departures. However, Hydro One's application

[102] Oral Hearing Transcript, Volume 3, Pages 40-41
[103] Oral Hearing Transcript, Volume 3, Pages 39-40
[104] Oral Hearing Transcript, Volume 3, Pages 42-43

already assumes and accounts for Hydro One's handling of such departures (i.e. management flexibility to run the operations and restructure/transform the workforce). As a result, the Board must assume that Hydro One's obligation to pay these compensation costs has already been incurred, and that these costs are not practically or legally avoidable, and must be treated as "committed" costs.

131. In the case of the PWU collective agreement, the PWU has significant bargaining power arising from the fact that Hydro One is unable to continue operations for a sustained period of time in the face of a work stoppage. In the absence of a negotiated agreement, Hydro One's options are to provoke a work stoppage which will, in turn, cause significant negative consequences to the reliability of the system and its customers. The most probable outcome is that the government would send the dispute to binding arbitration, likely resulting in a collective agreement as favourable, or more favourable to the PWU as was obtained through collective bargaining.

132. Hydro One's Human Resources strategy is to negotiate fair and reasonable collective agreements to foster and promote healthy union-management relationships.[105] As stated earlier, Hydro One has sought to achieve overall cost reductions by negotiating increased management flexibility to run the operations, as opposed to wide scale reductions in wages, benefits and pensions. It has achieved that goal.

133. The Board's task in assessing Hydro One's compensation costs is not to attempt to recreate the world as the Board would like it to be. Rather, it is to assess the reasonableness of Hydro One's conduct, given the factual and legal context in which Hydro One operates. One reality which the Board must understand is the challenge faced by employers who must, by law, negotiate collective agreements with sophisticated employee bargaining agents.

134. In conclusion, there is absolutely no evidence that Hydro One conducted itself during the negotiations with the PWU in any way which was imprudent or unreasonable.

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[105] Exhibit C1, Tab 3, Schedule 2, Page 4

There is no evidence that any more favourable outcome was available to Hydro One through any other course of action.

c. The Mercer Benchmarking Studies

135. The other pieces of evidence that affirm Hydro One's year over year performance in so far as total compensation is concerned are the three Compensation Cost Benchmarking studies conducted by Mercer. Hydro One retained the first two studies under the direction from the Board in Hydro One's previous rate cases, the "2008 Study" was filed in EB-2008-0272 and the "2011 Study" was filed in EB-2012-0031.[106] The Board directed Hydro One to conduct a total compensation study that "will provide useful and reliable information concerning Hydro One's compensation costs, and how they compare to those of other regulated transmission and/or distribution utilities in North America". Hydro One filed an updated study in this application in response to a stakeholder request, the "2013 Study".

136. As can be seen from Table 6[107] below, overall Hydro One is approximately 10 per cent above market median in 2013 which is an improvement from 2008 where Hydro One was 17 per cent above market median. The PWU is 12 per cent above market median which is a significant improvement from 2008 where the PWU was 21 per cent above market median. The SEP is 9 per cent above market median. The significant improvement for the PWU compensation costs is attributed to the increased use of hiring hall staff and the increased pension contributions negotiated as part of the new collective agreement.[108]

[106] Exhibit C1, Tab 3, Schedule 2, Page 2
[107] Exhibit C1, Tab 3, Schedule 2, Page 3
[108] Exhibit C1, Tab 3, Schedule 2, Pages 3-4

Table 6:

Mercer Compensation Benchmarking Study Results vs. Market Median Total Compensation

Employee Group	2013 Survey Results	2011 Survey Results	2008 Survey Results	Total Change from 2008 to 2013
Management	-1%	-17%	-1%	0%
Society	9%	5%	5%	4%
PWU	12%	18%	21%	-9%
Overall	10%	13%	17%	-7%

137. According to Mercer the shift towards market median was notable, especially given the peer group, like Hydro One, had worked to minimize labour costs through the substantial economic downturn which began in 2008.[109]

138. The Mercer studies clearly indicate a positive trend in Hydro One's compensation cost control efforts. The PWU submits that internal benchmarking/internal performance trends is the only viable and meaningful assessment as opposed to point-in-time comparisons of wage levels at Hydro One against wage levels in "similar" companies, using a simple application of external cost comparators.

139. Hydro One's objective is to approach the median and intends to achieve the necessary progress through collective bargaining:[110]

> **MS. LEA: Now, you are still 10 percent above the market median. Is it your view that you still need to make efforts to approach the median?**
>
> **MR. STRUTHERS: Yes, the company intends to approach the median. That's one of its objectives.**
>
> **MS. LEA: And how do you intend to do that over this five-year plan?**
>
> **MR. STRUTHERS: The progress will be made through collective bargaining, and it will be what we will be able to negotiate with the Power Workers Union and the Society of Professional Engineers.**

[109] Exhibit C1, Tab 3, Schedule 2, Attachment 1
[110] Oral Hearing Transcript, Volume 2, Page 142

MS. LEA: Do you have a specific target for this five-year plan?

MR. STRUTHERS: We have, certainly within our assumptions, we have indicated that the increase to -- for employee costs would be no more than 2 percent.

We expect that there will be other savings against that, though.

MS. LEA: So in looking at the O&M numbers that you have put forward as part of your five-year plan, is moving to the median or approaching the median baked into those forecasts?

MR. STRUTHERS: Our objective is to reach agreement with our Unions in the most commercial manner that we can, and to move towards that 50 percent, P50 position.

140. In response to Undertaking J3.11 Hydro One explains how the 2011 and 2013 Mercer studies were updated and improved:

> **The studies have been improved by increasing the size of the benchmarking participant group and adjusting some of the benchmark jobs to get a better assessment of Hydro One's total compensation. The basic methodology has been kept the same to show trends in Hydro One's progress to move closer to the total compensation median.**

141. During the oral hearing Hydro One was asked to calculate the total amount of compensation that would be payable if Hydro One was at the market median in 2014. In response to Undertaking J3.12 Hydro One indicated that:

> **Using the same methodology as used in the Mercer Study, Mercer has determined the difference to be $60.8M approximately 25.29% of which is allocated to Distribution. The resulting Distribution OM&A portion is $15.38M payable compensation over market median.**

142. The PWU submits that there is no evidence whatsoever that this is an achievable result for Hydro One given that approximately 90 per cent of Hydro One's workforce is unionized and wages and benefits are covered by the respective collective agreements and Hydro One is legally bound by the agreements. Changes to a collective agreement can only occur where bargaining produces new arrangements that both sides agree to.

143. In the pre-filed evidence,[111] Hydro One sets out a historical comparison of wage rates of a number of employee categories shared by it and two other Ontario Hydro

[111] Exhibit C1, Tab 3, Schedule 2, Pages 11-13

successor companies, Ontario Power Generation and Bruce Power. The key to the comparison is that all of these wage scales have the same starting point, which is the establishment of the successor companies in 1999.

144. The comparison demonstrates that from 1999 to 2013 Hydro One has been very effective relative to the other Ontario Hydro successor companies (dealing with the same bargaining agents). Hydro One has negotiated substantially lower wage scales than OPG and Bruce Power for all seven positions with the exception of one position for OPG.[112] The PWU submits that the comparison with Bruce Power is of particular significance due to the fact that Bruce Power is an unregulated, private sector operator where costs, including labour costs face "market discipline" and are managed on a competitive basis.

145. Hydro One operates in a unionized environment and it is an integrated business (Transmission and Distribution) that requires work and skill sets that are often more complex (i.e. Power Line Maintainer ("PLM")).[113] [114] PLM's, often work in a more rural setting than their counterparts in other LDCs. As well, a PLM at Hydro One often works on both Distribution and Transmission assets and is required to be knowledgeable and proficient with overhead, underground and submarine cable. This is not typical of the PLM role in other LDCs.[115] All of these realities must be taken into consideration when assessing Hydro One's compensation costs. It is submitted that Hydro One's wage levels are appropriate and should be approved by the board.

146. To conclude, Hydro One has achieved significant savings by prudently managing its compensation costs. Hydro One has appropriately managed those elements of its business that are within its control to minimize costs. Relative to other available alternative outcomes, Hydro One has pursued and obtained results on a prudent and reasonable basis. The PWU submits that in order for the Board to make a disallowance, a minimum essential precondition is for the Board to make a finding of fact, based on evidence, that there was an alternate course of conduct which was

[112] Exhibit C1, Tab 3, Schedule 2, Pages 11-12
[113] Exhibit C1, Tab 3, Schedule 2, Page 16
[114] Oral Hearing Transcript, Volume 4, Pages 44-45
[115] Exhibit C1, Tab 3, Schedule 2, Page 16

reasonably available to Hydro One, which, on the balance of probabilities, would have led to a better outcome. In the instant case, there is absolutely no evidence of anything that Hydro One could have or should have done differently which would have led to a lower cost outcome. Indeed, there is strong evidence to the contrary.

d. Pension and OPEB

147. Hydro One provides its employees future benefits that include pension and other post-employment benefits ("OPEB"). Pension and OPEB are incorporated by reference into the PWU and SEP collective agreements. As such, pension and OPEB, like wages, are outcomes of collective bargaining and are subject to all the same constraints with respect to bargaining power and bargaining outcomes as discussed earlier in relation to wages. They are part of the collective agreements reached through negotiations based on mutual interests and areas of trade-offs between the parties.[116] As a matter of law, changes in pension and OPEB can only occur where bargaining produces new arrangements that both sides can agree to.[117] The PWU notes that for pensions, the *Pension Benefit Act* precludes from reducing pension benefits already accrued to members of a pension plan.[118]

i. Pension

148. Hydro One has a contributory defined benefit pension plan covering all regular employees of Hydro One and its subsidiaries except Hydro One Brampton Networks Inc.[119] HONI's registered pension plan is a traditional, single-employer contributory defined benefit plan. Hydro One's registered pension plan is funded by members and Hydro One contributions. Independent actuarial valuations are performed every three years to determine the funded status of the registered pension plan and contributions

[116] Oral Hearing Transcript, Volume 3, Page 44
[117] *Ibid.*
[118] Oral Hearing Transcript, Volume 3, Page 52
[119] Exhibit I, Tab 2.3, Schedule 1 Staff 15, Attachment 1. Hydro One Networks Inc.'s Financial Statements, December 31, 2013, Page 14

that are required to fund any deficit.[120] Pension contributions are governed by collective agreements and must take into account legal considerations.

149. As noted by the PWU in cross examination, Hydro One has achieved significant increases in employee contributions in recent round of negotiations.[121] Hydro One submitted that in 2011 it negotiated a 0.5 per cent increase to the PWU employee pension contributions, i.e. an increase from 4 per cent of base earning to 4.5 per cent.[122] In the most recent round of negotiations, employee contributions have increased by a further 0.75 per cent in 2013 and 1.0 per cent in 2014,[123] i.e., the dollar value of the PWU's contribution for 2014 negotiated in the most recent collective agreement represents an increase of over 56 per cent since 2011.

150. The PWU notes that parties have raised from time to time questions as to why Hydro One has not considered making some structural changes to its pension plans such as changing its single-employer defined benefit plan to a jointly sponsored, 50/50 contribution scheme. Hydro One's witness in cross examination explained that there are some fundamental differences between its single-employer defined benefit plan and a jointly sponsored pension plans with a 50/50 contribution scheme,[124] one of which is that under a jointly sponsored pension plan the governance or administration of the plan (including its investment) is shared and plan changes must be agreed to by the sponsors jointly. Under Hydro One's plan, plan members have no control or even input to the plan administration.

151. The second major fundamental difference is that under a jointly sponsored pension plan with a 50/50 scheme, employers and employees share equally the benefits of any surplus in the plan. Under Hydro One's current plan, on the other hand, if there is a surplus, Hydro One can be excused from making some or all of the contributions, whereas, employees would continue to make contributions.

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[120] Exhibit I, Tab 2.3, Schedule 1 Staff 16, Attachment 2. Hydro One Networks Inc.'s Consolidated Financial Statements, December 31, 2013, Page 32
[121] Oral Hearing Transcript, Volume 3, Page 45
[122] EB-2012-0031 Transcript, Technical Conference, October 12, 2012, Page 95
[123] Exhibit C1, Tab 3, Schedule 2, Page 7
[124] Oral Hearing Transcript, Volume 3, Pages 55-56

152. In the PWU's view claims suggesting that there are savings available if Hydro One's contribution to the registered pension plan is equally shared with employees ignore the collective bargaining reality, fail to recognize the fact that there are absolute legal restrictions on reducing the benefits already accrued to members of the plan, and fail to recognize the fact that a 50/50 contribution scheme would force Hydro One and hence Hydro One's ratepayers to share any surpluses with Hydro One 's employees.

153. The PWU notes that there is an ongoing systemic review initiated by the Government of Ontario concerning the sustainability of electricity sector pension plans.[125] The PWU submits that the Board should not attempt to deal with, on ad-hoc basis, changes in cost sharing, governance, and other provision of pension and OPEB plan and, therefore, should not disallow any cost thereof underpinning HONI's proposed rates for the 2015-2019 test year period.

ii. OPEB

154. Hydro One's evidence indicates that under USGAAP for rate-setting purposes, Hydro One has the option of accrual or cash based recovery for pension, whereas for OPEB Hydro One cannot use the cash basis method for cost recovery:[126]

> **MR. CHHELAVDA: Well, for accounting purposes, you have to account for pension on the accrual basis. It is for rate-setting purposes you have the option of accrual basis recovery or cash basis.**
>
> **MS. LEA: And you are persuaded or convinced that that is not the same case for post-retirement benefits? That you cannot -- you cannot have them, for regulatory purposes, on a cash basis?**
>
> **MR. CHHELAVDA: That is correct. The codification is pretty specific in that area.**
>
> **MS. LEA: And where would I find that codification?**
>
> **MR. CHHELAVDA: So you would find that -- it is going to be in the US GAAP codification, so Accounting Standard Codification 980-715-25-4.**

155. As filed by Hydro One, for OPEB Accounting Standard Codification 980-715-25-4 sets out:[127]

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[125] Exhibit K2.1, CME Compendium, Tab 7. Report on the Sustainability of Electricity Sector Pension Plans to the Minister of Finance. March 18, 2014

[126] Oral Hearing Transcript, Volume 2, Pages 153

> **For OPEBs, ASC 980-715-25-4 states "For continuing postretirement benefit plans, a regulatory asset related to these costs shall not be recorded if the regulator continues to include other postretirement benefit costs in rates on a pay-as-you-go basis. The application of this Topic requires that a rate-regulated entity's rates be designed to recover the specific entity's costs of providing the regulated service or product."**

156. The PWU notes that the appropriateness of using the accrual accounting method for regulatory purposes was articulated by the Federal Energy Regulatory Commission ("FERC") in its *Statement of Policy on Post-Employment Benefits Other Than Pensions* (FERC OPEB Policy). In the PWU's view, FERC's key finding is that the proper recognition for rate setting purposes of OPEB accrued costs during the period in which the related benefits are earned is premised on the fact that OPEB are a form of deferred compensation to employees for the services that they provide during their working years. Specifically FERC's OPEB Policy states:[128]

> **It is self-evident that where a jurisdictional company's rates are to be judged just and reasonable based upon its cost of providing service, the Commission must prescribe the accounting principles it will use to define and measure the cost to track ratemaking... The Commission has examined SFAS 106 in this regard and finds the following:**
>
> > **a) PBOPs [Post-Employment Benefits Other Than Pensions] are a form of deferred compensation to employees for the services that they provide during their working years. Therefore, the costs of providing these benefits are properly included in the cost of service during the period that the benefits are earned.**
> >
> > **b) Measurement of PBOPs for a given rate test period is a process of allocating accrued costs between periods in a rational manner so that each period bears its equitable portion of such costs. SFAS 106 provides a reasonable convention for measurement of accrued costs including the transitional treatment of prior service costs ...**

157. The PWU agrees with Hydro One that the current treatment for cost recovery of OPEB costs on cash basis is consistent with the intergenerational equity principle.[129] In the PWU's view, the accrual method results in the appropriate matching of the recognition of the OPEB obligation by Hydro One when the related service is considered to be rendered and the benefit is considered to be earned, as opposed to

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[127] Undertaking J2.7

[128] Attachment to Exhibit I, Tab 4.03, Schedule 1, Staff 73. 61 FERC ¶ 61,330 (1992) [Docket No. PL93-1-000] Post-Employment Benefits Other Than Pensions, Statement of Policy, Pages 6-7

[129] Undertaking J2.7

cash basis which recognizes the OPEB obligation when the actual benefit payment is made to retirees in the future.

158. To conclude, there is no evidence in this proceeding that Hydro One's proposed OPEB costs underpinning the proposed rates for the 2015-2019 test-year period are unreasonable or that Hydro One's method of cost recovery is inappropriate.

159. To the extent that the Board is of the view that there is merit in considering the issue of a change in accounting treatment for regulatory purposes for OPEBs, it is submitted that a generic proceeding is the most appropriate method for that review. It is apparent that:

a) This is an issue that impacts most regulated utilities across the province. None of the issues are unique to Hydro One. The PWU understands that all utilities recover OPEB costs on accrual basis.

b) There is value in consistent treatment (and if not, an examination of whether inconsistent treatment is justified or even preferred is warranted);

c) The financial implications of forcing changes upon utilities is significant, and the full extent, seriousness and manageability and those implications have not been thoroughly canvassed; and

d) This issue is of such potential significance and complexity it warrants a proceeding in which it is the focus, rather than one many complex issues in a lengthy rate case.

160. These circumstances warrant a generic proceeding, if further inquiry into this issue is required.

161. Similarly, the PWU submits that the issue of whether Hydro One should be made to create an 'irrevocable trust'[130] for OPEB gives rise to similar issues as the "cash vs. accrual" issue. Insofar as the Board is of the view that this proposal merits

[130] Exhibit I, Tab 4.03, Schedule 1, Staff 73, c)

consideration, it is submitted that the proper forum for that consideration would be a generic proceeding, involving all regulated utilities.

E. REVENUE REQUIREMENT

Issue 6.1: Is the rate base component of the revenue requirement for 2015 as set out in the Custom Application appropriate?

Issue 6.2: Is the capital structure and cost of capital component of the revenue requirement for 2015 as set out in the Custom Application appropriate?

Issue 6.5: Is the OM&A component of the revenue requirement for 2015 as set out in the Custom Application appropriate?

162. Hydro One's application provides five years of revenue requirements to accommodate the necessary investments in infrastructure and system integrity work to ensure continued safe, reliable and secure service.[131] The revenue requirement will be set for a five-year period and rates will be fixed and predictable, subject to moderate and traditional mechanical year-end adjustments (i.e. current rates of return, changes in tax rates).[132]

163. Hydro One has committed to an aggressive productivity improvement effort embedded in its forecast of essential costs over the next five years. The business plan is based on a rigorous bottom-up approach to budgeting which incorporates aggressive efficiency gains and these embedded efficiency gains have significantly reduced the forecast level of costs. In other words, but for these projected efficiency savings embedded in the forecast, the proposed revenue requirement would be much higher.[133]

[131] Exhibit A, Tab 4, Schedule 1, Page 2
[132] Hydro One Argument-in-Chief, Pages 2-3
[133] *Ibid.*, Page 3

164. Hydro One's forecasted rates revenue requirement for the test years is: $1,367.0 million for 2015, $1,473.7 million for 2016, $1,528.1 million for 2017, $1,566.1 million for 2018 and $1,609.9 million for 2019.[134]

165. The increase in revenue requirement throughout the test year period 2015-2019 is primarily due to the growth in rate base. The amount of incremental revenue requirement that is attributable to rate base growth is clearly indicated in Table 7 below:[135]

Table 7

	2011 to 2015	2015 to 2016	2016 to 2017	2017 to 2018	2018 to 2019
Change in OM&A	18%	43%	7%	-27%	-9%
Rate Base Growth	94%	45%	80%	111%	89%
Change in Cost of Debt	-11%	6%	10%	16%	22%
Change in Cost of Equity	1%	6%	11%	4%	0%
Tax - Timing Differences and Other	-1%	1%	-6%	-6%	-1%
External Revenue	0%	-1%	-2%	2%	-1%
Other	0%	0%	0%	0%	0%
Total Change	100%	100%	100%	100%	100%

166. Hydro One's evidence clearly shows that Hydro One has made its utmost effort to take into account customer needs and to minimize total bill impacts. Hydro One's proposed rate smoothing strategy has revenue requirement increasing by approximately 6.3 per cent annually over the next five years as opposed to the 10.5 per cent increase that would be experienced in 2015 with the unsmoothed revenue requirement. The increases in the smoothed revenue requirement have a relatively small impact on the average customer's total bill: -1.5 per cent in 2015, 1.3 per cent in 2016, 0.8 per cent in 2017, 0.4 per cent in 2018 and 0.9 per cent in 2019.[136] In fact, the impact on the average customer's total bill is less than the rate of inflation during the test years.

[134] Undertaking J3.3, Page 2
[135] Undertaking J2.1
[136] Exhibit A, Tab 3, Schedule 1, Page 6

167. The need for increasing capital investment has been an issue in previous Hydro One rate applications and is a core part of the current application. Hydro One's revenue requirements over the test years reflect the substantial capital investment that is needed to address assets nearing their end-of-life, to improve the deteriorating distribution system and maintain the current level of reliability.

a. Rate Base

168. Hydro One's forecasted rate base for the 2015, 2016, 2017, 2018 and 2019 test years is $6,553.3 million, $6,864.4 million, $7,191.4 million, $7,541.3 million, and $7,869.6 million, respectively.[137]

169. The growth in rate base reflects the capital additions made during the three year IRM period and the proposed additions during the test years, as well as the inclusion of in-service assets totalling $564.9 million previously recorded as regulatory assets (Smart Meter, Smart Grid and Distributed Generation)[138] effective January 1, 2015.

170. As per Table 8[139] below the impact of increased rate base from 2011 to 2015 is substantial due to the fact that Hydro One experienced three years of large capital expenditures that were not fully recovered during the IRM period from 2012 to 2014. Hydro One is now entitled to recover a return on the investments it has made now that these investments are used and useful assets that have entered service.

Table 8

Impact of the Individual Component on Rate Revenue Requirement ($ Millions)

Description	2015 vs. 2011	2016 vs. 2015	2017 vs. 2016	2018 vs. 2017	2019 vs. 2018
Increase in OM&A	39.3	45.9	3.8	(10.1)	(3.9)
Impact of increased rate base	204.2	47.7	43.6	42.3	39.1
Lower/Higher cost of debt	(23.9)	6.4	5.4	6.1	9.6
Higher allowed ROE	1.3	6.9	5.8	1.5	-
Tax - timing differences and other	(3.0)	0.9	(3.1)	(2.5)	(0.5)
Lower/Higher external revenue	3.8	(0.9)	(1.1)	0.7	(0.6)
Total Change	**221.7**	**106.7**	**54.4**	**38.0**	**43.7**

[137] Exhibit D1, Tab 1, Schedule 1, Page 2
[138] *Ibid.*, Page 3
[139] Exhibit E1, Tab 1, Schedule 1, Table 7, Page 6

171. Substantial and necessary capital investments are needed during the test period from 2015 to 2019 and it is those facilities coming into service during the test period which have the largest impact on rate base and the revenue requirement.[140]

172. Hydro One has identified the major drivers of the in-service levels requested in the test period:[141]

- new connections and upgrades;
- troubled calls and storm damage;
- the replacement of assets at the end of their expected service lives;
- system capability reinforcements;
- joint use and relocation capital projects;
- ending the Smart Grid pilot project and beginning deployment of Smart Grid;
- line improvement capital projects to ensure supply reliability to distribution customers.

173. The PWU notes that Board Staff submitted that Hydro One's average smart meter cost per installed meter of $568 is not in line with that of other electricity utilities. In its submission, Board Staff provided average costs per meter for four utilities that in its view face similar issues of density and remoteness to Hydro One. While noting that it would be somewhat arbitrary to propose a figure for the Board's consideration, Board Staff suggests that a 20 per cent premium above the highest previously approved per meter cost of the four selected utilities (i.e. $403) could be a reasonable amount to allow per meter. According to Board Staff, that would result in a reduction of about $85 per meter amounting to a total of $103 million.[142]

174. The PWU recognizes the Board's right and responsibility to examine the proposed costs and to make determinations as to whether or not they are prudent. It is important to recall, however, the nature of the costs in question. These are the historical costs of a capital program which was undertaken in the past. As a result, the

[140] Hydro One Argument-in-Chief, Page 8
[141] Exhibit D1, Tab 1, Schedule 2, Pages 3-4
[142] Board Staff Submission, Pages 85-89

task the Board is being required to undertake here is what it has characterized as an "after the fact prudence review".[143] As described by the Board in EB-2010-0008:

> **Somewhat different considerations will come into play when undertaking an after-the-fact prudence review. In the case of an after-the-fact prudence review, if the Board disallows a cost, it is necessarily borne by the shareholder. There is no opportunity for the company to take action to reduce the cost at that point. For this reason, the Board concludes there is a difference between the two types of examination, with the after-the-fact review being a prudence review conducted in the manner which includes a presumption of prudence.**[144]

175. The Board Staff's submissions make no reference to the application of the presumption of prudence, nor whether there is evidence sufficient to rebut that presumption. Moreover, Board Staff makes no attempt to identify contemporaneous evidence which was available (or ought reasonably to have been available) to Hydro One, which demonstrates that the manner in which Hydro One planned to proceed with its Smart Meter Installation program was not prudent. The PWU submits there is no such evidence.

176. In any event, the PWU notes that the information regarding the comparison of Hydro One's smart meter costs against that of four other utilities was submitted by Board Staff for the first time in its final submission. In other words, other parties of the proceeding have not had the opportunity to test the comparability of Hydro One's smart meter related costs and that of the other utilities.

177. Moreover, in assessing Hydro One's smart meter related costs, it is important to consider all the factors that Hydro One listed in Exhibit J3.02 as responsible for Hydro One's higher costs:[145]

> **The following are key considerations that Hydro One believes need to be taken into account when reviewing Exhibit K3.1:**

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[143] EB-2010-0008 at p. 19, Rev'd: *Power Workers' Union (Canadian Union of Public Employees, Local 1000) v. Ontario (Energy Board)*, 2013 ONCA 359 (CanLII). As the Board is aware, there is an ongoing dispute regarding the proper scope of the application of a prudence review, presently before the Supreme Court of Canada. For the time being, the decision of the Court of Appeal is binding on this Board. More importantly, the nature of the costs in question in relation to smart meters clearly falls within even the Board's restrictive interpretation of a prudence review.

[144] EB-2010-0008, *supra.*

[145] Exhibit J3.02

- **Hydro One operates in a much larger geographical territory than other distribution entities, with a more dispersed customer base and hence the costs incurred in the installation of smart meters will vary significantly and not be comparable to other distribution entities**

- **As a result of the larger geographical territory that Hydro One operates in, higher up front infrastructure costs and additional equipment costs are involved in setting up the smart meter communications equipment (e.g. labour installation costs, data collectors, data repeaters, etc.)**

- **Exhibit K3.1 is prepared as a 'point in time' analysis. However, by combining both capital and OM&A costs together, the specific time frame you look at or the further out you look in the analysis (i.e. 2006 to 2009 or 2009 – 2014 or 2014 - beyond), the higher the average cost per meter costs may be calculated and hence the calculation can vary significantly**

178. The PWU submits that the Board should not be making arbitrary smart meter cost reductions or disallowances based on cost information provided for the four other utilities that in the PWU's view are not comparable to Hydro One.

b. Capital Structure & Cost of Capital

179. Hydro One has applied the deemed capital structure of 60 per cent debt and 40 per cent common equity in determining its 2015-2019 revenue requirements.[146]

180. Hydro One's capital structure was approved by the Board as part of its April 9, 2010 Decision (EB-2009-0096) and this is consistent with the Report of the Board on the Cost of Capital for Ontario's Regulated Utilities dated December 11, 2009 (EB-2009-0084).[147]

181. Hydro One's application proposes annual adjustments for recurring events that are mechanical in nature (i.e. changes in cost of capital)[148] and has followed the Board's prescribed methodology for capital structure and cost of capital.

182. As indicated in the PWU's comment under Issue 1.1, the PWU is opposed to Board Staff's recommendation that the Board set Hydro One's cost of capital at the outset for the entire five test years.

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[146] Exhibit A, Tab 3, Schedule 1, Page 3
[147] Exhibit A, Tab 3, Schedule 2, Page 1
[148] Exhibit A, Tab 4, Schedule 1, Page 3

183. The PWU submits that the capital structure and cost of capital component of the revenue requirement for 2015 as set out in the Custom Application are appropriate and should be approved by the Board.

c. OM&A

184. In comparison to the 2014 bridge year, total OM&A expenses for 2015 actually decrease by $17 million (3 per cent). Total OM&A expenses are expected to increase from $564.3 million in 2015 to $614 million in 2017 and then decline to $600 million in 2019. The PWU notes that the overall increase is less than the projected rate of inflation over the same period.[149]

185. As stated earlier, Hydro One indicated that the increase in OM&A is essentially found in the sustaining and operations budgets.[150] The evidence indicates that the major contributor in the increase of sustaining OM&A is vegetation management which was discussed in greater detail under Issue 3.1.

186. Although there is an increase in OM&A over the test years for line clearance and vegetation management, the overall increase in OM&A over the test period is quite low and begins to decline in 2018 and 2019.

187. A reduction in the proposed vegetation management budget for the 2015-2019 test period would result in lower reliability levels and ultimately higher vegetation management costs in the future. The PWU submits that the OM&A component of the revenue requirement for 2015 and the remainder of the test period are appropriate and should be approved by the Board.

188. The PWU respectfully submits that Hydro One's revenue requirements for the test years are prudent. The PWU supports Hydro One's proposed rate smoothing strategy and the stability it will provide for customer's rates throughout the test years. In the absence of evidence that any of the cost components in Hydro One's application are imprudent, the Board should approve Hydro One's proposed revenue requirements for the test years.

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[149] Hydro One Argument-in-Chief, Page 11
[150] *Ibid.*

All of which is respectfully submitted.