October 15, 2014

Mike Belmore
External Relations Officer,
The Society of Energy Professionals
2239 Yonge St
Toronto, ON M4S 2B5

VIA Canada Post and RESS Filing

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

Re: EB-2013-0416 Hydro One Networks Inc.
2015 - 2019 Distribution Custom Incentive Rate Setting Application
The Society of Energy Professionals Final Submissions

Dear Ms. Walli,

Please find attached The Society of Energy Professionals' Final Submissions in the Hydro One Networks Inc 2015 - 2019 Distribution Custom Incentive Rate Setting Application, EB-2013-0416.

Two (2) hard copies of this submission have been sent to your attention.

Sincerely,

Mike Belmore
External Relations Officer
The Society of Energy Professionals

Copy by email: regulatory@HydroOne.com

2239 Yonge St
Toronto, Ontario M4S 2B5
www.thesociety.ca
Tel 416-979-2709
Toll Free 1-866-288-1788
Fax 416-979-5794

The Society of Energy Professionals
FINAL SUBMISSIONS

EB-2013-0416 Hydro One Networks Inc.

2015 - 2019 Distribution Custom Incentive Rate Setting Application

15 October 2014

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EB-2013-0416: The Society Final Submissions

Introduction:

This is the Final Argument of The Society of Energy Professionals ("The Society") in the Hydro One Networks Inc. 2015 - 2019 Distribution Custom Incentive Rate (CIR) Setting Application, EB-2013-0416. This Argument is organized in the same manner as the Issues List, with numbering and sub-numbering that matches the issues list numbering scheme.

Rather than put forward positions on all issues, The Society has chosen to limit itself to those largely which it considers to be of primary concern to its interests and where it can provide a different perspective for the OEB's consideration in reaching its decision in this proceeding.

On the other issues, The Society supports the position put forward by the Company.

1.0 CUSTOM APPLICATION

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

The Society supports the position put forward by the Company.

1.2 Has Hydro One Distribution responded appropriately to all relevant Board directions from previous proceedings, including commitments from prior settlement agreements?

The Society supports the position put forward by the Company.

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)?

The Society supports the position put forward by the Company.

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?

The Society supports the position put forward by the Company.

2.0 OUTCOMES AND INCENTIVES

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?

The Society supports the position put forward by the Applicant.

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)?

The Society supports the position put forward by the Applicant.

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?

The Society supports the position put forward by the Applicant.

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

With some modifications, as outlined below, The Society supports Hydro One's proposal regarding the monitoring and reporting of performance as outlined in J5.7, and further detailed in the other evidence this undertaking references [J4.5, J4.8, TCJ1.16].
With regards to the Hydro One Distribution Outcome Measures provided in TCJ1.16, The Society proposes that the following additions be made:

a) For Vegetation Management, provide the annual remaining backlog percentage of clearing the forestry right of way required to bring this to an eight-year cycle. This would provide a valuable progress indicator. As per Mr. Brown, there is currently a 23% backlog beyond an eight-year cycle [Tr. 4, page 179]. This would infer that the backlog would have to be reduced by about 3% per year in order to meet the target of reaching the eight-year cycle within eight years. So, for example, if the Company has a 20% backlog in 2017 then it is seriously off track in how it is approaching the program.
b) Also for Vegetation Management, provide the annual target of kms to be cleared, which would obviously have to tie-in to getting to an eight-year cycle within eight years. As with a) above, if Hydro One annually materially undershoots this target then the program is seriously off track.
c) For Substations Refurbishments, provide the annual targets for total refurbishments, as well as the targets for the subset of Integrated Modular Distribution Station [iMDS] installations. There is a significant increased spend in this work program due to the condition of this equipment. Hydro

One should be ready and willing to demonstrate that it is meeting the self-described vital work accomplishment requirements of this program.

The Company proposes to provide the Hydro One Distribution Plan Approval memo annually as per J4.8. The Applicant should be required to provide a reconciliation with the annual levels approved by the OEB in this proceeding including the rationale for any major deviations. This will provide the OEB and interested parties with an early warning system as to whether The Company might be approaching an off-ramp scenario.

The annual Productivity / Cost Efficiencies accomplishment file should include a reconciliation with Exhibit I-2.03-6 VECC42 for all prior years e.g. the accomplishment file with 2016 actuals should also include the actual levels for 2013, 2014 and 2015 and include the reconciliation for 2014 and 2015. This file must also include a summary of how annual total "excess" productivity / cost efficiency improvements were re-invested into Hydro One Distribution work programs.

2.5 Are Hydro One Distributions' proposed off-ramps, annual adjustments and annual adjustments outside the normal course of business appropriate?

The Society supports the position put forward by the Applicant.

2.6 Are Hydro One's forecasts (revenue, costs, inflation and productivity) reasonable? Should Hydro One be expected to provide benchmarking evidence as an indicator of reasonableness?

The Society supports the position put forward by the Applicant.

2.7 Is Hydro One's proposed annual reporting and stakeholder engagement process appropriate?

The Society supports the position put forward by the Applicant.

2.8 Should the application provide appropriate incentives for line loss reduction?

The Society supports the position put forward by the Applicant.

3.0 PROGRAM AND PROJECT EXPENDITURES

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?

The Society supports the position put forward by the Applicant.

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?

The Society supports the position put forward by the Applicant.

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?

The Society's position is that Hydro One has demonstrated sufficient, sustainable productivity improvements through the test period. As outlined in its response to interrogatory I-3.03-12, the Company's average annual productivity savings through the period is 7.1% of revenue requirement. In J2.3, the Company calculated that its productivity x-factor is 0.85, substantially exceeding the PEG target of 0.60 [as provided in K2.1, Tab 8 "Empirical Research in Support of Incentive Rate-Setting: 2013 Benchmarking Update —Report to the Ontario Energy Board prepared by Pacific Economics Group Research, LLC, 8 July 2014", table 4]. These calculated levels of productivity are not insubstantial and are clearly to the benefit of ratepayers.

A very important factor, which was not highlighted in evidence and during the oral hearing, is that the Company's primarily rural and physically vast service area footprint greatly limits the degree to which productivity gains can be achieved. The Company's overall cost of service is reasonable once its service territory is taken into account. However as compared to primarily urban LDC's its cost of service will be by definition always higher. This is analogous to assuming that the cost for a homeowner to fix an emergency leaking pipe in their cottage, including their travel time, should equal doing the same in their primary residence; that is just not possible. Which is not to say that Hydro One has not, cannot and will not make productivity improvements, as it has and will, but simply that there are real life limitations to what can be done to lower the cost to deliver and maintain service. Unfortunately it would not appear that econometric models favoured by consultancies like PEG can adequately take this into account.

Prior Period Savings

The Applicant's forecast productivity improvements include those initiated prior to the CIR test period but to which benefit is enjoyed by ratepayers through the five year test period. Some intervenors and Board staff took the view that these types of savings should not be taken into account during the five year CIR test period, which would result in an estimated productivity x-factor of 0.29% as provided in J4.2. This Panel will have to choose what the appropriate treatment of these savings should be during a five year CIR period. Effectively intervenors are encouraging LDC's not to initiate substantial once a decade step change productivity initiatives until the second test year of a five year CIR period; otherwise an LDC will not be allowed recognition of these savings which substantially benefit ratepayers through this

period. So for example, Hydro One should not have implemented its new CIS in 2014, but waited until 2016 for the implementation. This would effectively be promoting illogical business practices amongst LDCs: that is, in order to get credit for them, delaying implementing substantial productivity initiatives from the bridge year or the first year of the CIR period until the second or third year of the CIR period. This is unreasonable.

Productivity & Cost Efficiency Benchmarking

The Society supports the approach taken by Hydro One to bridge the gap between the unavailability of productivity benchmarking data and implementing viable productivity metrics. The Society also provides a recommendation for the OEB's consideration to facilitate exchange of information regarding productivity initiatives amongst LDC's. Despite the absence of productivity benchmarking studies, Hydro One has been able to implement and apply productivity metrics as recommended to it in a study it engaged the Oliver Wyman consultancy to prepare several years ago.

As outlined in the Oliver Wyman consultancy study, their continent wide survey of 17 regulators observed that "no regulatory commission was found to routinely request measures of productivity from utilities under their jurisdiction" [Exhibit I-3.3-9 SEC 30, "Measuring Productivity at Hydro One", by the Oliver Wyman consultancy, dated December 15, 2011, page 1]. This highlights the fundamental difficulty in attempting to benchmark productivity improvements in the electricity industry; even regulators do not have a standard productivity measure to utilize.

In terms of benchmarking in general, various witnesses informed the Board that industry organizations such as the CEA no longer undertake benchmarking. As stated by Mr. Struthers, utilities generally no longer participate in benchmarking studies through concern that "information or data they may provide will then become publicly available" [TR.4, page 80]. No solution to this dilemma is apparent other than as Mr. Quesnelle stated, arranging some sort of cross-jurisdictional regulatory compact to keep participant data confidential, which in of itself would be a challenge to reach [refer to TR.4 pages79-84 for the full discussion of this issue between Mr. Struthers and the Panel].

Further, under cross examination [Tr. 2, pages 105-106], Ms. Frank confirmed that she does not recall the OEB providing any documentation to LDC's on the annual productivity savings levels actually achieved by other LDC's or forecast test years productivity savings for those LDC's who just had completed a cost of service proceeding. From The Society's perspective, a partial solution for the absence of more useful productivity benchmarking data may be for the OEB to facilitate annual exchange of outlines of productivity and cost efficiency initiatives undertaken by LDC's within Ontario as well as individual LDC actual and forecast test years annual savings levels. This may provide more useful and actionable information to LDC's than the econometric productivity benchmarking information provided in the reports issued by PEG. If this became an annual OEB reporting requirement with a set format and contents [eg two page outlines of each material productivity

initiative undertaken] it would simplify the broad exchange of this information amongst LDC's and introduce them to new approaches to gain productivity improvements which they may not have been aware of. As outlined in J5.7, Hydro One has agreed to provide "an annual Productivity / Cost Efficiencies accomplishment file", so this could be leveraged by Board staff to determine an effective format for all LDC's to use in annual productivity reporting.

Several Hydro One witnesses confirmed that many new productivity metrics recommended in a consultant's report several years earlier have been implemented by the Company and used in monthly reporting [Exhibit I-3.3-9 SEC 30, "Measuring Productivity at Hydro One", by the Oliver Wyman consultancy, dated December 15, 2011]. For example, under cross examination by Mr. Rubenstein regarding new productivity metrics recommended to Hydro One Networks as found on page 2 in the referenced report, Mr. Brown stated:

> **[Tr. Volume 5, pages 158,159]**
> *It appears that most of these metrics are things that I see in our monthly performance review of our program versus budget, actuals versus budget, not only on a cost perspective, but we also measure the throughput. … in terms of managing it, issues and problems associated with not meeting our unit costs or our program throughput are things that get escalated in the company for reso -- must be getting late in the day -- resolution. … And so we're able to actually take swift action or at least have an explanation as to why something might be going in a certain direction on a month-by-month basis.*

So utilization of these new metrics has and does contribute to actively reducing and controlling costs and contributing to the Company's cost conscious culture.

Cost Conscious Culture

Various Hydro One witnesses confirmed through the oral hearing the cost conscious culture of the Applicant. For instance:

> **[Tr. Volume 5, page 159]**
> *MR. BROWN: Those are goals of the company, is to try and lower the unit cost. In a given year, those discussions are around: How are we making out with this particular productivity improvement we already have embedded in our plan? Is it yielding the results that we want to have it yield? Yes or no? If not, why?*
> *Our goal at the end of every year is to meet our plan, both in terms of cost and in terms of work throughput.*
>
> **[Tr. Volume 4, pages 57,58]**
> *MR. STRUTHERS: The pressure on us to keep -- or continue to drive efficiencies is there. Whether it is from the outside reviews that are being done on the company, whether it is from pressure from our shareholder, whether it is from pressure from our board, whether it is from the Hydro One board, whether it is from pressure from our customers, or whether it is pressure from the entire regulatory environment, there is a clear understanding that the company needs to continue to press to be more efficient.*

Hydro One has Underestimated Productivity Savings

The Society's position is that Hydro One has understated its cost efficiency savings through the test period, not to the detriment of ratepayers as work programs have been appropriately priced, but in making its own case in justifying its CIR proposal. Though Hydro One has properly costed out its work programs over the CIR period with productivity savings and cost efficiencies built in to work program costing, it has been overly conservative in quantifying and pricing the productivity and cost efficiency savings it will gain over this time frame. This was confirmed in testimony during the oral hearing.

Mr. Scott, the business planning witness confirmed that the work program pricing over the 5 year CIR period was properly done:

> [Tr. Volume 3, pages 132, 133, 134]
> *MR. DUMKA: We have heard from Mr. Struthers a number of times the assumption of 2 percent a year is the assumed increase in compensation costs.*
> *So I am curious as to how you would cost out the other components of your work program if you are doing a capital build, the cost for, I don't know, transformers, cabling, or whatever else. … [assume that] you buy your distribution transformer in 2016 or '18, that's the timing, so what is the pricing assumption? Does that come from you folks [the Hydro One Business Planning unit], or is it left up to the manager responsible for that program for his pricing assumptions for the equipment that he is the technical expert for?*
> *MR. SCOTT: They would be working with the supply chain folks as to a pricing structure.*
> *MR. DUMKA: Okay. So I guess, stepping back -- and this is a 12,000-foot view of what is happening -- so the technical expert deals with supply chain, in terms of assumptions going forward for purchasing, let's say however number of distribution transformers, and he lands on a pricing scheme or assumption for the five-year business plan that we see reflected here.*
> *MR. SCOTT: Yes.*

Hydro One's lead witness on productivity and cost efficiency presented largely a "hindsight" view of savings being gained i.e. future savings are the same dollar value in total as past savings despite changes in work volumes and increased economies of scale in material and equipment purchases:

> [Tr. Volume 3, pages 139, 140]
> *MR. DUMKA: … if there is a variation in the price going forward, it's going to be reflected in the savings that you are going to get, because even if the overall price is going up, if you're buying ten more units than you were five years earlier, you're going to get a discount on that. That is my proposition.*
> *MR. AMODEO: I understand that, yes. In volume, pure volume, yes. But I do want to point out that there are risks.*
> *[…]*
> *MR. QUESNELLE: I am just trying to understand how the number [quantity of savings] was derived. Is it --*

MR. AMODEO: It was just an estimate based on what we -- what we saved in the prior year, and we felt that -- we know in some cases volume will be going up, and we know that apples and apples, volume going up, we should be saving money, but there is that other risk of what happens in the market.

MR. QUESNELLE: So given that, you've decided to use, as a proxy for what may happen, a hindsight look at what happened in the most recent year that you have actuals?

MR. AMODEO: Yes.

A very specific and illustrative example of the underestimation of savings is the further gains which will be afforded to rate payers through the gradual introduction of standard equipment designs through the next five year period [eg moving from say 90 different distribution station transformer designs to 20 designs. This would simplify station design and gain economies of scale pricing for purchases of fewer different types of transformers). It is not clear from Mr. Amodeo's straight line estimation of productivity savings that the cost savings which gradual standardization of station equipment, including transformers, would afford is realistically quantified.

[Tr. Volume 5, pages 172,173]

MR. DUMKA: Is Hydro One moving to, I'll call it, standard designs and sizes for transformers and other types of equipment, so that -- picking numbers out of the air; I didn't see it in evidence -- let's say you've got right now 80 or 90 different types of transformers you use around the province, … is there an intention going forward that you're going to standardize to 10 or 20 designs as you go in and do these major refurbishments? Is there an intent to move down that path?

MR. BROWN: Yes, there is.

MR. DUMKA: What's the timeline for that in terms of establishing these new standards for transformers and then doing the purchasing and all that?

MR. BROWN: I would say that within the business plan, within the 2015 to '19 period, I would say we want to have ourselves very solid in terms of what that looks like.

MR. DUMKA: So in other words, next time Hydro One's here, you're going to have your new standards for transformers that you're going to be rolling out, going forward from that point? So that would be a fair assessment?

MR. BROWN: That would be a fair assessment.

MR. DUMKA: And does that kind of standardization that ties into the modularization, is there a similar sort of thing afoot for other types of equipment in the station, like reclosers or whatever else? Or is that a little bit more particular? I'm just curious in terms of moving to standardized sizes, et cetera, so you don't have as many different types of spares and all that.

MR. BROWN: I think I could characterize it that for components contained within the stations, we've already done a fair bit of work around that already.

MR. DUMKA: Okay.

MR. BROWN: For breakers, reclosers, even to a certain degree transformers and their sizes, we've done some work down that path already.

MR. DUMKA: Okay.

MR. BROWN: What I'm talking about in terms of the '15 to '19 plan is more the larger picture. When we do a full station refurbishment, what does that look like in terms of standards?

Further to Mr. Amodeo's straightlining of savings, when examining the more detailed list of productivity initiatives provided in Exhibit I, Tab 2.03, Schedule 6 VECC 42, it is not obvious why some initiatives with a labour component do not annually increase in savings gained. The Hydro One CFO clearly stated under testimony that labour pricing will increase by 2% per annum, however a number initiatives stay constant in savings gained including:

- Fleet Mechanic reduction [$666k per year from 2014 to 2019]
- CIS [$19785K per year from 2015 to 2019]
- Forestry Asset Condition Assessment incorporated into Lines inspection [$946k per year from 2015 to 2019)
- Integrated Modular Distribution Station [iMDS] design stays constant at $500k savings per station from 2014 until 2019 increasing to a level of $3500k by 2019. (as per Mr. Brown, Tr. Volume 5 pg 69, "[savings are] about half a millions dollar savings per station. So what we have currently in the business plan is to do between five and nine units per year with the iMDS going forward").

If as little as 25% of the above savings initiatives are reduced labour costs, then savings have been understated by at least $750k. There are a variety of other initiatives in the referenced IR response which appear to have straightlined labour component savings.

An example which includes both types of systemic underestimation of productivity savings by Hydro One [economies of scale savings from equipment purchases & constant dollar pricing of labour savings] is the integrated modular distribution station [iMDS] initiative, which is being utilized in about 20% of the total number of distribution stations refurbishments between 2015 and 2019 (as per J5.5 about 30 iMDS projects out of a total of 194 station refurbishments). The underpricing of labour savings in constant dollars is addressed in the previous point. With regards to the underpricing of equipment purchase savings in the iMDS initiative, Mr. Amodeo stated:

[Tr. Volume 3, page 139]

For instance, you know, inflation, marketing conditions, the cost of these commodities, or whatever that they're buying. Right? I mean, there is some -- there is some risk there. And, you know, you just can't say, Your volumes are going up; therefore, you know, we're going to buy more, so we should have more savings.

I totally understand that, but there is another piece of that, and that is: What is the price you're going to be paying three, four years from now?

The obvious answer to Mr. Amodeo's question is that whatever price you are paying, it will be lower than it otherwise would due to economies of scale volume

purchases, you will be paying less on a per unit basis than you otherwise would with your old way of doing things.

New Productivity Savings Which Might Be Gained & How To Utilize Them

Assorted witnesses testified that Hydro One anticipates that it may find further productivity savings going forward which one would expect in a company with a cost conscious culture. The Society supports the Company's proposal to invest any such additional savings in its work programs, to the benefit of ratepayers, as confirmed for example by Mr. Struthers [Tr. Volume 4, page 64] and Mr. Brown [Tr. Volume 5, page 88]. As outlined in the Company's response to J5.7, through the 2015 to 2019 period it intends to file an annual Productivity/ Accomplishment file. This should allow Board staff as well as interested parties to ascertain if and how Hydro One has exceeded its proposed annual productivity targets as well as how any resulting additional program funding was invested.

Through examining what other companies are doing, Hydro One is gaining and will gain future productivity improvements. For instance, Mr. Brown testified that the concept for the integrated modular distribution station design [iMDS] savings is "actually something that we have learned about from other utilities who have been quite successful in driving costs out of their station renewal programs as a result of using a modular station" [Tr. Volume 5, pages 70,71]. Mr. Irvine also testified that Hydro One is investigating how to make further efficiency gains through examining what other companies are doing:

> **[Tr. Volume 5, page 58]**
> *MR. IRVINE: ... The one thing that we are doing -- and again, this is through CEATI, which I mentioned earlier -- we're on a distribution asset life-cycle management committee, and at that group we do discuss all kinds of best-practice type things and share ideas around the entire business of managing our assets.*
> *So we are linked in with what other folks are doing to try and do things better and more cost-effectively, and should things come out of that group that will allow us new initiatives to make us more efficient, then we will look for those to be implemented within our organization. And we hope that what that allows us to do is to reinvest those efficiencies back into the network.*

Both Mr. Brown and Mr. Irvine testified that through the test period, productivity / cost efficiency gains through the implementation of the smart grid initiative have been included [e.g. Tr. Volume 5, pages 124,125, Mr Brown stated "any savings we have been able to identify and attribute to smart grid are embedded in our models right now. Okay? Our OM&A and our capital expenditures, if there's any savings that we have, they're already in our numbers."]. However, further productivity / cost efficiency gains from smart grid technology may be leveraged on a case by case basis [Tr. Volume 5, pages 125-128].

Mr. Winters, who last year was appointed Senior Vice President of Engineering and Construction, also testified as to how in his organization he will leverage enterprise

systems and processes to gain further productivity savings in his line of business over the next several years [Tr.2 pages 111, 112]. These savings would be over and above the three Engineering & Construction line of business savings which Mr. Amodeo straightlined in I-2.03-6 VECC 42.

3.4 Is the company's effort to reduce line losses appropriate?

The Society supports the position put forward by the Applicant.

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

4.1 Are the business planning processes, assumptions and policies used by Hydro One Networks to develop and allocate its distribution and transmission revenue requirements appropriate?

The Society supports the position put forward by the Applicant.

4.2 Is the proposed level of 2015-2019 common corporate costs spending appropriate with an adequate demonstration of efficiencies over the 5-year period?

The Society supports the position put forward by the Applicant.

4.3 Are the methodologies used to allocate common corporate costs to the distribution and transmission businesses and to determine the overhead capitalization rate for 2015-2019 appropriate?

The Society supports the position put forward by the Applicant.

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

The Society supports the Company's position that it has put forward a compensation strategy resulting in reasonable compensation costs. Hydro One has assumed annual labour increases of 2% through the test period, which would be in the range of or less than annual inflation through the period. In order to further reduce compensation costs, between 2013[1] and 2019 Hydro One will have: increased the proportion of work executed by substantially lower paid temporary and casual staff by roughly 20%, and; increased the proportion of pension costs paid by employees by 50% (see discussion further below). As shown in J3.6, the proportion of casual and temporary staff to total staff increases from 33% in 2013 to 39% by 2019. As a

[1] 2013 is used as the base year in the compensation discussion as this is the last year for which actuals are provided in terms of headcount; it is the basis for data used in the "Mercer - Compensation Cost Benchmarking Study -Hydro One Networks Inc.", December 9, 2013, and; any results discussed in the "Report on the Sustainability of Electricity Sector Pension Plans to the Minister of Finance, March 18, 2014" by Jim Leech, Special Advisor.

direct result, average base pay over the period only increases by less than 8%, whereas wages are assumed to increase less than 13%, a material difference. Further, the Hydro One witness outlined how any further changes in compensation levels would be bound by the results of collective bargaining, and as such cost efficiencies have been found and will be sought in the test years to further offset compensation costs:

> [Tr. 3, page98]
> MR. STRUTHERS: What we are -- we are effectively bound in our compensation by collective agreement structures. Normally, what a corporation would do is it would try to find additional synergies or -- in order to offset areas where it might be high in terms of a particular cost, and that's what we currently do and continue to strive to do.
> So if we can find efficiencies in the back office we will find efficiencies in the back office to try and offset some of those additional costs.
> We have varying input costs, so for example copper costs change, aluminum costs change, and we're trying to find efficiencies in terms of either how we buy the stuff or other ways in trying to keep those costs down. So it is a constant process for us to find efficiencies to keep costs down, and particularly if you think of it through an incentive ratemaking period, the company would be incented to do that, and we continue to be incented to continue to use those processes.

Compensation Benchmarking Study

A certain amount of attention was given to the results of the 2013 Mercer Compensation Benchmarking study [aka Mercer study] and its inferences [Exhibit C1-3-2, Attachment 1, Mercer - Compensation Cost Benchmarking Study -Hydro One Networks Inc., December 9, 2013]. The Mercer study showed that overall Hydro One compensation had improved from 17% above market median in 2008 to 12% above market median in 2011 to 10% above market median in 2013. This was driven primarily by Hydro One's increased use of lower compensated PWU hiring hall staff through the period. This is the same cause and effect outlined in the previous paragraph regarding the increased use of temporary and casual staff (the latter includes PWU hiring hall] between 2013 and 2019.

The Society supports Mr. Struthers proposition that one cannot estimate where Hydro One would sit versus market median compensation in 2019 based upon the 2013 Mercer study results [Tr.2 pages143-145 and Tr.3 pages192-193]. As Mr. Struthers outlined, one would have to conjecture what the peer group companies' relative compensation levels would be in 2019. An alternative view is that the Mercer studies have shown Hydro One has improved from being 17% above market median in 2008 to 10% in 2013 (an average improvement towards market median of 1.4% per year). Based upon these facts, one could conjecture that between 2013 and 2019 that Hydro One would move 1.4% per year closer to market median, resulting in the Company being 2% above market median in 2019, which most would consider as being essentially at market median. This "forecast" is based upon empirical fact, however the same shortcomings apply to it as Mr. Struthers has

outlined in testimony i.e. one cannot estimate where the comparator peer group would be relative to Hydro One in 2019.

Compensation Benchmarking Study – The Society Results

One or two intervenors highlighted and took exception to The Society category of employees ["Professionals" in the Mercer study] shifting from 5% above market median in 2011 to 9% above market median in 2013. This result appears to be an anomaly as The Society contract has resulted in 2% per annum wage increases since the 2011 Mercer study, whereas the PWU has received greater wage increases through the period yet have moved closer to market median, though still further from median than The Society. Due to several factors, which follow, The Society believes that the Mercer study does not adequately reflect the position of Society staff versus the market median. As a consequence, if another Mercer compensation benchmarking study is prepared for a future Hydro One rates application, The Society will require a more thorough analysis and audit of the draft study report before it is finalized.

The different companies in the Mercer study peer group have impacted The Society category results, as was explained by the Hydro One witness:

> [Tr. 3, page97]
> MR. STRUTHERS: But, again, the problem with benchmarking, it depends how many of those comparables [peer group companies] would have had […] equivalent Society position, and then if I was to lose one of those comparables, what the impact might have been on the benchmarking as a result.
> When we talk to Mercers about the increase in the Society, one of the answers they came back with is because the benchmarking comparables had changed, and it would have had an impact on that result.
> I am not saying that you can't take something away from the increase. I'm just saying that you've got to sort of consider that in the outcome when you look at it.

In The Society's view, another factor which contributes to this anomaly in Mercer study results is the inadvertent under representation of temporary Society staff in the study as well as the potential incorrect costing of the total compensation of temporary Society staff. In contrast to regular Society staff, temporary Society staff generally do not receive health and dental benefits or are members of the Hydro One pension plan, hence their total compensation costs are substantially lower than regular Society staff [Tr. 3 pages 145, 146]. This is the same situation with PWU hiring hall positions, whose increased use thereof and inclusion in the Mercer study has moved Hydro One closer to market median. If Mercer had not been given the correct data to ensure that Society temporary staff were properly costed then their total compensation would have been materially overstated, thus pushing The Society category further above market median. Further, in order to substantiate whether a representative proportion of Society temporary staff had been included in the Mercer study, Hydro One was requested to provide the appropriate data in

J3.8, however this data was not forthcoming[2]. For illustrative purposes to quantify the impact of potential under representation of Society temporary staff in the Mercer study, the proportion of 2013 year end casual staff to the peak level during the year provided by Mr. Struthers in testimony was applied[3]. On this basis it was estimated that 42 temporary Society staff should have been included in the Mercer study rather than 21 (as indicated by Hydro One in J3.8), which would result in The Society category being 8% above from market median rather than 9%.

Pension Sustainability Report

The special advisor's report on electricity sector pensions ["Report on the Sustainability of Electricity Sector Pension Plans to the Minister of Finance, March 18, 2014" by Jim Leech, Special Advisor, as provided in K2.1 Tab 7] generated a great deal of cross-examination and discussion during the oral hearing. In contrast to the negative impression generated in the report, Hydro One's witness Mr. Struthers outlined how the Hydro One pension plan in 2013 "was one of the top performing pension plans in Canada and it had very good returns. …. The plan has exceeded its target, yes, since its inception" [Tr. 3, page144]. Mr. Struthers also stated that "I would characterize it that the report is being reviewed, that the government is looking at how that report might be implemented"[Tr. 3, page143]. Mr. Struthers later stated "that implementation is going to require the Ontario government, the employees -- sorry, the employer and the unions to work together to be able to implement it, so it is an ongoing process" [Tr. 3, page199]. In other words, if the Ontario Government chooses to implement some aspects of the Special Advisor's report recommendations, it will work together with the employer, The Society and the PWU to reach some common agreement on how to implement the subset of recommendations. As such, The Society's position is that it would be premature for the OEB to take the entirety of this report's recommendations as fait accompli and presume implementation outcomes in this proceeding.

Changes in Employee Pension Contribution Levels

The Pension Sustainability report noted that the employee pension plan contribution level in 2013 was 23%, and as summarized in Exhibit I, Tab 4.03 Schedule 1, Staff 68, the employee pension plan contribution level will be increasing from 28% in 2015 to 35% in 2019. This is a very substantial increase of 50% in the employee pension contribution level over the period. Board staff's submission also made note of this as a positive indication [Board Staff Submission, October 7, 2014 page 55]. Mr. Struthers outlined that if the proportion of employee to employer pension contributions changed further from these levels assumed in the test period, the ratepayer would be held true as any such changes would be held in

[2] In undertaking J3.8, Hydro One was requested to provide the total population of Society represented staff in Hydro One Networks, broken down between regular and temporary, as of 1st July 2013 [Tr. 3 pages 147, 148]. This is the date the Mercer study data was pulled. However, in its J3.8 response, Hydro One provided data as of 2013 year end.

[3] Tr.3 pages103,104 in reference to C1-3-2, Attachment 2, page 2

MR. STRUTHERS: And if I can point out at the bottom of that page, it indicates the casual number of workers is 1,781. … And so I say, this is a year-end number. During the year the number of casual employees would have been anywhere between 2,800 and 1,600.

the "Pension Cost Differential Account" (a deferred pension variance account) for later disposal.

[Tr. 4, pages53,54]

MR. RUBENSTEIN: And we have discussed that you believe there will be two rounds of PWU bargaining within the test period and probably two more Society collective -- rounds of collective bargaining within the test period.

And if you have not made any assumptions that there will be a change in the employee-employer ratio for the test period, how should the Board handle that? There's sort of an expectation. I don't know what it's going to be. There is going to be some changes within the next five years. We don't know how -- we don't know what the magnitude of that is.

But you have not actually assumed any changes into your forecasts for the test period. How should the Board handle that?

MR. STRUTHERS: As I indicated, there is a variance account that deals with the pension issue. So to the extent that the pension contributions by the company are less than the amount that is in the base or more than, then there is a variance account.

So any additional employer contributions could be dealt with through that variance account.

MR. RUBENSTEIN: So it is your understanding that the variance account covers not just changes to valuations but also changes to the employer-employee contributions.

MR. STRUTHERS: It is based on cash contributions by the company. So if the cash contribution by the company decreases because the employer contribution -- employee contribution increases, then that would be dealt with through that account[4].

5.0 DEFERRAL AND VARIANCE ACCOUNTS

5.1 Are the proposed amounts, disposition, discontinuance and continuance of Hydro One Distribution's existing deferral and variance accounts, as set out in the Custom Application, appropriate?

The Society supports the position put forward by the Applicant.

5.2 Is it appropriate to include in rate base, effective January 1, 2015, the following in-service assets which are presently recorded as regulatory assets:

a) smart meter assets as of December 31, 2013, the costs for which are recorded in variance accounts 1555 and 1556;

[4] Mr. Struthers' explanation is consistent with the prefiled evidence. As explained in Exhibit F1, Tab 1, Schedule 1 Page 8, "The account [Pension Cost Differential Account] tracks the difference between the non-capital portion of pension cost estimates, based on actuarial assessments and other forecasts [such as the proportion of employee to employer pension contributions], upon which Hydro One Distribution's Rate application is based, and the actual pension contributions charged to OM&A."

b) smart grid assets as of December 31, 2013, the costs for which are recorded in account 1536; and
c) assets to facilitate distributed generation as of December31,2013, the costs for which are recorded in account 1533.

The Society supports the position put forward by the Applicant.

6.0 REVENUE REQUIREMENT

6.1 Is the rate base component of the revenue requirement for 2015 to 2019 as set out in the Custom Application appropriate?

The Society supports the position put forward by the Applicant.

6.2 Is the capital structure and cost of capital component of the revenue requirement for 2015 to 2019 as set out in the Custom Application appropriate?

The Society supports Hydro One's proposal to annually update the cost of capital for the rate year using the OEB issued ROE and short-term debt rates issued each preceding fall for the 2015 to 2019 rate years. This also includes the updating of the long term debt rate to reflect all actual debt issues and retirements. This is consistent with the approach used annually by Hydro One Transmission to determine its rate year cost of capital as directed by OEB panels in their last several Hydro One Transmission cost of service proceeding decisions.

However, as Hydro One Transmission will be updating its cost of capital for its rate year at almost exactly the same time each fall as Hydro One Distribution, it is recommended that the OEB require both Hydro One Networks businesses to use a consistent Hydro One Networks debt portfolio for its calculations. This will ensure that a timing issue does not result in one Hydro One Networks business incurring a slightly different cost of capital due to new borrowing which may be primarily initiated to deal with the needs of the other business. This should not be an issue for Hydro One as their witness Ms. Frank confirmed that there will be consistency in the cost of capital calculations for both the Distribution and Transmission businesses for at least the next two rate years [Tr. 2, page103].

6.3 Is the depreciation component of the revenue requirement for 2015 to 2019 as set out in the Custom Application appropriate?

The Society supports the position put forward by the Applicant.

6.4 Is the taxes / PILs component of the revenue requirement for 2015 to 2019 as set out in the Custom Application appropriate?

The Society supports the position put forward by the Applicant.

6.5 Is the OM&A component of the revenue requirement for 2015 to 2019 as set out in the Custom Application appropriate?

The Society supports the position put forward by the Applicant.

6.6 Is the load forecast a reasonable reflection of the energy and demand requirements of the applicant? Is the forecast of other rates and charges appropriate? Is the forecast of other revenues appropriate?

The Society supports the position put forward by the Applicant.

7.0 COST ALLOCATION AND RATE DESIGN

The Society supports the position put forward by the Applicant on the Cost Allocation and Rate Design sub-issues.

ALL OF WHICH IS RESPECTFULLY SUBMITTED ON THIS 15th DAY OF OCTOBER, 2014