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By Email and RESS

October 15, 2014

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Re: Hydro One Distribution Rates 2015-2019 (EB-2013-0416)
- SIA Final Argument

Dear Ms. Walli,

Attached please find the Final Argument of the Sustainable Infrastructure Alliance of Ontario (the "SIA") in the above noted proceeding.

Sincerely,

[original signed by]

Dionisio Rivera

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.

Final Argument on behalf of the Sustainable Infrastructure Alliance of Ontario

October 15, 2014

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Introduction:

On December 19, 2013, Hydro One Networks Inc. ("HONI") filed an application with the Ontario Energy Board (the "Board") for an order or orders approving distribution rates for a five year period, commencing January 1, 2015.

The process included a pre-hearing conference, extensive interrogatories, a technical conference, an ADR, and an oral hearing.

These are the submissions of the Sustainable Infrastructure Alliance of Ontario (the "SIA"). For ease of reference, the submissions address the issues before the Board under main topic headings, rather than by individual issue.

On select issues, most notably cost allocation and rate class considerations, the SIA makes no submissions and takes no position. On a general principled basis, however, the SIA would support any decision in these particular areas to consider concepts of simplification and standardization.

Application Format and Presentation:

HONI filed its application under the Board's Renewed Regulatory Framework for Electricity Distributors ("RRFE"), under the "Custom IR" rate-setting option. It described its approach as a "Custom COS" approach, and presented its information in a manner generally reflective of the format of its past COS rate applications.[1] In certain areas, this presentation was not in alignment with the Board's updated Filing Requirements For Electricity Distribution Rate Applications ("Filing Requirements").[2]

[1] Exhibit A, Tab 4, Sch 1
[2] IR 2-SIA-2

With regard to data presentation and categorization specifically, HONI justified its approach by claiming that it was at least partly in response to intervenor requests.[3] While the SIA cannot comment on this directly (as it was not part of the pre-filing conferences), the SIA does not believe that intervenors would ever request that HONI not adhere to the Filing Requirements in preparing its application. The SIA submits that there is a fundamental difference between how financial information is categorized (which is something that distributors should be allowed to customize), and in what structure it is presented in a rate application (which is something that, for comparability and simplicity, should follow a common standard). Contrary to HONI's claim, the SIA does not believe that the flow, comparability, or "accurate reflection of Hydro One's internal investment planning and reporting processes and decisions" would have been "compromised" had HONI more strictly followed the order and structure of the Filing Requirements, and believes that doing so would have greatly aided intervenors (and possibly the Board) in managing and reviewing what is a relatively lengthy and complicated package of material.[4]

Despite the "custom" nature of the Custom IR rate-setting option, the SIA believes that the Board intended all rate application filings to follow common elements and a common format, as described in the Filing Requirements. The SIA believes that the manner in which the information was presented by HONI in this proceeding veered too far away from the Board's intended standard practice, and found the general non-conformance to the format presented in the Filing Requirements a little confusing and unhelpful to the process. This confusion was also touched upon by Board Staff, particularly with regards to the location (within the application) of specific required data points, and a lack of a single consolidation DSP.[5]

While certainly not something that can be rectified in this proceeding, the SIA requests that the Board provide strong direction to HONI to require it to more stringently comply with the Filing Requirements and other guiding Board documents in all future filings and applications.

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[3] IR 2-SIA-1 and IR 2-SIA-2
[4] IR 2-SIA-2
[5] Board Staff Argument, Section 4.1

Application Theory and Rationale:

HONI's application for rates, supported largely by the results of customer surveys, is based on the assumption that current reliability levels are acceptable. As such, there is little or no expectation to improve reliability, only to maintain it at the lowest possible cost.[6]

That, in itself, could be a justified rationale for the application. However, the SIA submits that the problem with this approach is the proposed cost of implementation and resulting rate impact, both of which are of a magnitude at which customers, ratepayers, and the general public's expectations will be substantially higher than for HONI to simply maintain the status quo.

It would be one thing for HONI to propose total cost increases at the inflation level and tell its customers to expect unchanged reliability. It is another thing for HONI to ask for sizeable rate increases over the 5 year term and promise to attempt to maintain the same level of service. The SIA submits that in response to this proposition a reasonable customer would either say – "you're charging too much for the same product" or "you're not delivering enough for what I'm paying".

The Board's dilemma, the SIA believes, is in finding that right balance between what HONI is claiming its customers want, and what it should actually cost to provide it. If the Board accepts the premise that HONI's customers are happy to maintain current reliability, then the focus should be on finding the true cost of providing this service. If the Board finds that HONI's proposed costs are warranted, then more must be expected of HONI in terms of reliability, efficiency, and service improvements. In either case, the SIA submits that HONI must offer more, in terms of lower costs or higher value or some combination of both, than what it has put forward in its application.

In the SIA's opinion, an attempt to maintain reliability is generally an acceptable outcome, provided that continuous minor improvements to reliability are implemented where prudent and feasible, such that the overall long term value to the customer and level of service trends upwards, however marginally. The SIA agrees with HONI that based on its survey results,

[6] IR 2-SIA-11

customers would not want larger rate increases in order to aggressively invest in assets in order to improve service. However, this approach should not suggest that no investments in service improvements should be undertaken. Certainly where feasible, prudent, or cost effective, some level of continuous improvement is desirable.

The Absence of Benchmarking and External Verification:

A major issue noted by Board Staff and virtually all intervenors to this proceeding has been the absence of any benchmarking or external verification to support the validity, composition, and magnitude of HONI's capital and operating expenditure requests.

The Board's RRFE report is clear in that benchmarking is a required element of any rate application, even if it may ultimately only be used in a supporting role.[7] In its recent Enbridge Decision, the Board further clarified and emphasized this requirement, stating that "an applicant for Custom IR is also responsible for providing a robust plan which is properly documented and supported."[8] The Board goes on to say with regard to benchmarking that "the RRFE Report is quite clear that the Board expects such analysis to be presented in the application"[9]

In the absence of such verification and benchmarking, the SIA submits that it becomes difficult for the Board to accept that HONI's application is reasonable in its presentation of costs and sharing of risks and benefits with its customers.

The absence of external verification or benchmarking on such a costly, complex, and long term application as presented by HONI does not inspire confidence.[10] The SIA, like other intervenors, is concerned about the accuracy of what HONI is presenting, and with its limited insights into HONI's operations can only go so far in questioning the validity of the plan. In more simple terms – HONI is asking the Board to trust that the application before it is accurate in presenting the optimum amount of work that needs to be completed over the test year period

[7] RRFE Report, page 11
[8] Enbridge Decision (EB-2012-0459), page 5
[9] Enbridge Decision (EB-2012-0459), page 8
[10] IR 3.2-SIA-44

at a reasonable cost. In response, the SIA and many other intervenors are simply finding it a hard proposition to accept (particularly given the magnitude and length of the term of the application) without some external comparator or independent 3rd party report.

The SIA believes that while not determinative, the absence of any external benchmarking and independent review is certainly detrimental to the application, and casts a level of doubt on all projections put forward by HONI. The SIA submits that that the Board should consider this in reviewing the requests of HONI, and factor it into any adjustments, reductions, or deviations that it may require HONI to undertake as part of its decision. In other words – the Board should give consideration to the concept that the absence of benchmarking should itself result in additional reductions to HONI's requests to account for the uncertainty of the validity of the cost information presented. These reductions should be in addition to any regular reductions that the Board would require of HONI in reviewing the application in the normal course (e.g. for prudence, etc).

The Rate Framework:

The Boards RRFE Framework requires distributors to provide detailed evidence of its capital investment plans. This is particularly emphasized for distributors, like HONI, who are filing under the Custom IR rate setting method:

> "The Board expects that a distributor that applies under this method will file robust evidence of its cost and revenue forecasts over a five year horizon, as well as detailed infrastructure investment plans over that same time frame."[11]

The SIA submits that the evidence HONI has presented in this application, while extensive, is not on its own sufficiently detailed and robust to fully support its investments and cost requests. As noted earlier, the absence of benchmarking evidence and/or independent 3rd party verification introduces a level of doubt as to the accuracy and prudence of the presented information.

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[11] RRFE Report, page 19

Similarly, HONI's claim that it has built efficiency and productivity savings into its forecasts is also, in the SIA's opinion, unsupported by compelling evidence. In the absence of benchmarking, the Board and intervenors are unable to confirm the validity of these assertions.[12]

Additionally, the SIA notes that a vast majority of the savings HONI claims have been incorporated into its application are a result of initiatives completed prior to 2014.[13] More recent initiatives over the test year period produce significantly lower savings results. The SIA submits that it is not proper to attribute savings from prior years as part of productivity and efficiency savings over the test year period. It is the SIA's understanding that the COS rebasing process is intended to reset rates and pass on any savings achieved over the prior period to ratepayers. Once rebased, it is up to the utility to find new additional savings, not rely on ongoing past savings to justify its efficiency in future periods.

The SIA submits that these two fundamental deficiencies – namely a lack of benchmarking and 3rd party verification of its proposed spending, as well as the absence of verifiable productivity savings - leave the OEB little choice but to assume some level of reduction to HONI's revenue requirement to be necessary. This overall reduction would encompass both reductions as a result of unsupported prudency of any particular program or capital investment, as well as an implied reduction to account for productivity and efficiency savings that HONI should be expected to achieve over the plan term.

Subject to categorically ineligible expenditures or clearly imprudent investments that could be denied outright, the SIA further believes that it is not in the Board's interest to micromanage HONI's operational plan. In keeping with its approach in many past applications, the SIA submits that the Board should allow HONI to manage within an approved "envelope" of either OM&A and capital, or in more closely reflecting the principles of the RRFE, revenue requirement.

HONI has presented in its application 5 years of COS data detailing its planned expenditures. To account for the absence of benchmarking, 3rd party verification, and verifiable productivity savings, the Board could apply a reduction to each of OM&A and capital spending value to

[12] IR 2.2-Staff-11

[13] Transcript Volume 3, page 16.

reflect these deficiencies on an annual basis. The reduced OM&A and capital could then be used to produce new revenue requirements for each of the five years of the plan. It would then be up to HONI to manage within these revenue requirements, by allocating its OM&A and capital to those programs it deems most necessary, and trying to complete as much of its planned work with the rates made available to it. This approach would follow HONI's Custom COS approach to this rate application, and be reflective of the approach the Board had taken in past multi-year applications by both HONI (EB-2009-0096) and Toronto Hydro (EB-2007-0680), among others.

Alternatively, the Board could approve the revenue requirements largely as filed (subject to any modest program specific adjustments it deems reasonable appropriate), and apply a productivity and stretch factor, mirroring the standard approach under the IRM rate setting method, under which a productivity and stretch factor are applied to a distributor's rates. This approach (subject to any modest adjustments deemed appropriate) would implicitly accept the costs, investments, plans, and targets presented by HONI in this application, but require them to be achieved at a lower cost on account of productivity and efficiency savings. This is essentially the same approach as advocated for by Board Staff in their submissions (albeit framed slightly differently), and also the approach preferred by the SIA.

The SIA notes that the current productivity factor for Ontario utilities is set at 0%, and the highest stretch factor (currently applicable to HONI in its group) is 0.6%. Given that HONI was able to present its costs in this application without the constraints of the inflation factor as applicable to other utilities under IRM, the SIA submits that a higher productivity and stretch factor should be applied. The SIA would suggest that an annual productivity and stretch factor in the range of 1.0%-1.25% would be appropriate, applied cumulatively in each of the five years of the plan. This is slightly higher than the 1.0% factor suggested by Board Staff. Additionally, the SIA would suggest that the productivity and stretch factor applied in the first year of the plan be applied at half the rate of the remaining four years (i.e. 0.5%-0.625%), to account for the fact that productivity initiatives will take time to implement, and to more closely treat the first year of HONI's application as a "rebasing year", which under regular IRM rate setting is typically not subject to productivity or stretch factors.

Outcome Measures and Metrics:

As part of its application, and in addition to the mandatory metrics that are to be reported annually through the Electricity Distributor Scorecard, HONI is also proposing eight custom outcome measures targeted to specific areas where HONI is planning to increase Capital or OM&A expenditures.[14] HONI states that these performance measures are intended to monitor its success in delivering planned results over the 5 year term.

The SIA has some concern that the measures, as proposed, do not assume any particular level of efficiency or productivity improvement.[15] That is, they do not assume a steady number of units replaced with a decreasing budget, nor an increasing number of units replaced with a steady budget. What HONI appears to be suggesting is – here are the number of units we plan to replace at a certain budget, and at the end of each year we'll inform the Board whether we achieved our plan. The SIA submits that this is not a particularly helpful approach to measuring outcomes and demonstrating efficiency or productivity, because no efficiency has been built into the targets. The measures as presented are fully planned and funded[16] – and as such the only way they could not be met is if HONI deliberately under-spends or fails to manage the planned execution. Conversely, HONI could always meet the targets simply by spending more if it was falling behind, even if it spends more than was budgeted. The more informative measure, in the SIA's opinion, is not whether HONI can replace x units in a year, but whether HONI can replace x units in a year at a cost lower than the prior year.

Notwithstanding the above, and while supportive of Board Staff's submissions on this issue[17], if the Board were to accept the outcome measures, the SIA is curious how any global reductions in requested funding will affect HONI's proposed measures. That is, if HONI's capital budget is reduced, or if a productivity and stretch factor is applied, HONI is likely to argue that it will need to spend less, and achieve less, than originally proposed in its measures because it has less funding available to it. This dependence on approved budgets, in the SIA's view, highlights the weakness of these measures – they will demonstrate whether what was approved by the Board

[14] Exhibit A, Tab 4, Sch 4
[15] IR 2-SIA-15
[16] Undertaking J4.9
[17] Board Staff Submissions, Section 2.5

was ultimately completed or not, but do not provide any goals for HONI to try to find ways of doing more with less, or at lower cost.

Capital Plan:

Subject to its earlier comments concerning productivity, efficiency, and benchmarking, the SIA is generally supportive of the capital investment plan put forward by HONI. Among the SIA's primary objectives is to advocate for sustainable, prudent, and cost effective investment in infrastructure, and as such it is supportive of HONI's efforts to modernize its distribution system and reach a state and pace at which it can optimize the life cycle cost of each asset.[18] The SIA also believes that given HONI's expertise in managing its distribution system, it is most appropriate to allow HONI to identify the investment needs that it feels are required to its distribution system, and to make those corresponding investment decisions.

Generally, given the information available, the SIA has found much to support in the investment plans presented by HONI, and (subject to productivity and efficiency savings) has not identified any significant specific investment decision with which it would be in direct disagreement. However, given the magnitude of proposed investments, the SIA believes that the Board and parties would have benefitted from additional detail in the asset investment planning and prioritization process, as well as more program specific details. Similarly to the concern about the absence of benchmarking, and despite the SIA's general support for the proposed programs, the lack of full clarity in this information causes some doubt as to level of spending required in certain specific areas.

The SIA notes that increases in certain areas are substantial. For example, spending on station refurbishment more than doubles over the term of the plan.[19] Given such increases, and despite the SIA's belief that the majority of these investments are prudent and necessary, the SIA submits that it would have been beneficial to the Board if more detailed information was available to more unreservedly support such a conclusion.

[18] Transcript Volume 5, page 19
[19] Exhibit D1, Tab 3, Sch 2

The SIA also notes that HONI has confirmed that major outages are a particular concern to its customers.[20] This is in alignment with the SIA's own internal observations, and the SIA would encourage HONI to be particularly mindful of potential opportunities to implement mitigation measures against major storms and lengthy outages over the test year period.

OM&A:

HONI has applied for a specific OM&A budget for each of the 5 years of the rate plan. In general, the SIA believes that the OM&A budgets put forward by HONI are fairly balanced, modest, and not unreasonable given the identified needs and the size of the capital investment program.

However, the SIA does have a few specific concerns with regard to spending that appears to be, unnecessarily in the SIA's estimation, veering beyond the core role of distribution. Of particular note, the SIA does not believe that proposed spending on CDM and CDM development, of approximately $3.0 million annually[21], is appropriate given the great need for infrastructure investment and renewal. HONI sites a recent Toronto Hydro decision in which application filing costs were denied primarily for reasons of materiality.[22] The SIA submits that this issue is irrelevant to the costs under consideration. HONI also relies on a prior 2010 rate Decision (EB-2009-0096) to justify continued expenditure on CDM development.[23] The SIA respectfully submits that the roles of distributors in CDM have changed since the time of that decision, and CDM program development costs should not continue to be included in base distribution rates.

The OPA is charged with developing CDM programs for the province of Ontario, and utilities have been implementing the OPA's programs with OPA funding. Under the CDM Code, utilities are also permitted to apply for Board-Approved CDM program funding, but critically, these programs are not funded through base distribution rates. If HONI wishes to develop and apply for a Board-Approved CDM program, it should do so through an appropriate application to the Board. HONI should not, however, be granted what the SIA believes is largely an exploratory research and development budget, to develop and test CDM programs in parallel with the OPA's own efforts. The SIA believes that given pressing needs for infrastructure renewal and investment as presented in

[20] IR 2.1-SIA-4
[21] Exhibit C1, Tab 2, Sch 5, page 15
[22] IR 3.1-SIA-26
[23] IR 3.1-SIA-26

this application, such discretionary expenditures are not prudent nor in the best interests of HONI's customers.

There are other areas of spending for which the SIA could question the absolute need, level, or prudency but these are relatively immaterial in comparison to the total revenue requirement. Additionally, if the Board is to adopt the approach of top-level reductions to OM&A and capital or revenue requirement as earlier advocated for by the SIA, than any such potential spending reductions would be absorbed under the high level reduction to the OM&A spending envelope, and a reallocation on a program level could be managed internally by HONI. The only exception to this would be expenditures (such as potential CDM expenditures) which the Board could determine are categorically imprudent or inadmissible for recovery through distribution rates.

Cost of Capital:

HONI has requested to annually update its cost of capital parameters over the course of the 5 year term. This is in alignment with past multi-year applications by HONI (EB-2009-0096, EB-2012-0031) and several other distributors (e.g. Toronto Hydro EB-2007-0680). However, an annual update of this nature appears to be less in alignment with the Board's new RRFE Framework. While the SIA does not strongly advocate for either option, on balance, and to maintain consistency with other utilities on the new 5-year rate plans, the SIA believes that it would be more appropriate to set the cost of capital once for the duration of the term, such that no updates to these parameters would need to be considered on a reoccurring annual basis.

Smart Meter Cost Recovery:

As part of this application, HONI has requested clearance of $445.1 million in smart meter capital costs and $59.4 million in smart meter OM&A costs incurred over the 2009 to 2014 period.[24] The SIA is concerned with the relatively high costs of the smart meter implementation presented by HONI in this application, particularly given the fact that HONI is as of yet unable

[24] Transcript Volume 3, page 6

to complete its roll-out to its entire customer base and will be unable to do so during the term of the plan.[25]

The SIA's primary consideration is whether the relatively high costs claimed for recovery were prudently incurred. In this regard, the SIA is in agreement with and strongly supports the submissions of Board Staff in advocating for a reduction by the Board to the amount ultimately permitted for rate recovery.

Rescheduling Appointments Service Quality Metric - Exemption Request:

As part of its May 30, 2014 update, HONI filed a request for an exemption from a provision of the Distribution System Code governing the tracking and reporting of the Rescheduling Appointments service quality metric.[26]

In making this request, HONI is claiming that largely on account of its service territory it is unique among Ontario utilities and fundamentally unable to meet the Board's required target for this metric.[27]

The SIA is sympathetic to HONI's concerns. In the SIA's view, meeting any metric 100% of the time is a matter of compliance, not a realistic "target" for a performance service quality metric. However, the SIA disagrees that this issue is unique to HONI. In briefly reviewing the 2013 OEB Yearbook results, the SIA notes that more than half of utilities do not even report on this measure (39 out of 72 show their results as "N/A"), suggesting data on this metric is only partial at best.

Fundamentally, while the SIA does not disagree with the intent of the metric and the requirement behind it, the SIA does not believe that this is something that needs to be tracked by utilities on an ongoing basis. The SIA notes that the Board has numerous requirements that by definition must be met 100% of the time (e.g. call a customer 48 hours before attempting to disconnect for non payment, put a customer on a 21 day collections hold if contacted by a social

[25] IR 3.2-SIA-37
[26] Exhibit A Tab 18, Sch 1 Appendix A
[27] IR 2-SIA-10

service agency, etc[28]), but the Board, properly in the SIA's estimation, does not require that data to be tracked for the purpose of determining to what degree each of these requirements are being met. The Board is simply confident enough in the compliance of utilities that the requirements are being followed, and any instances of non-compliance are addressed on a case by case basis. The SIA believes that this metric should be treated in a similar manner.

As a general observation, it only takes one incorrectly rescheduled appointment to fail the metric for the entire year, regardless of however many appointments are correctly rescheduled. It also tracks an action that affects a tiny fraction of all customers. Using HONI's own data from the 2013 yearbook, HONI met 98.4% of all appointments it made with customers. Of the 1.6% that it missed, it failed to correctly reschedule 12.9% (100%-87.1%). The metric then, in effect, describes HONI's failure to properly apply the rules to only 0.2% (1.6% x 12.9%) of all customer appointments. Given the relatively small numbers affected, this tracking does not seem to be prudent nor necessary. The numbers for other utilities are even lower, and for those utilities reporting 100% on an annual basis, the effort required to track the value is just an unnecessary confirmation that the rules are being followed in their entirety as intended. This is in contrast to other metrics (telephone accessibility, appointment scheduling, etc) which, aside from demonstrating compliance, also reveal the level of service being provided above and beyond the minimum.

The SIA would suggest that the OEB review this metric on an industry-wide basis, and either postpone ruling on it in this proceeding, or extend HONI's request on an interim basis only. The SIA does not believe that the issues relating to this metric are unique to HONI alone.

The SIA notes that Board Staff appears to support a similar approach – "Any review of the 100% standard is more appropriately done on a generic basis for all distributors. Board staff understands that the Board may be reviewing its Service Quality Requirements."[29]

[28] Distribution System Code, Sections 4.2.2.4 and 4.2.2.6
[29] Board Staff Submissions, page 91

Low-Income Energy Assistance Program:

In its evidence, HONI shows that it is planning to provide $1.2 M in funding to the Low-Income Energy Assistance Program (LEAP).[30] The SIA requested clarification as to how this value had been calculated, and to confirm that HONI used 0.12% of its Service Revenue Requirement in determining the amount in accordance with the Board's guidelines on LEAP funding.[31] In response, HONI stated that "The $1.2 million was calculated based on the prescribed OEB formula of 0.12% of HONI's Service Revenue Requirement."[32]

However, HONI's Service Revenue Requirement for 2015 is forecast to be $1,414.9 million.[33] Multiplying this amount by 0.12% results in a projected LEAP amount of $1.7 million, not $1.2 million as stated in HONI's evidence.[34]

While not a material difference in terms of revenue requirement, the SIA believes that this is a very material difference in terms of overall annual LEAP funding. The SIA submits that as part of its decision, the Board should direct HONI to correctly calculate its LEAP contribution amount to reflect its allocation amount in accordance with the Board's LEAP guidelines and the Filing Requirements.

Unforeseen Events and Off-Ramps:

Hydro One proposes customized annual adjustments to protect both it and its customers against unexpected developments beyond the control of management.[35] The SIA is primarily concerned with the need for customized adjustments given the similarities with existing Board mechanisms.

The SIA asked HONI how its customized adjustment mechanism differed from the Board's standard Z-Factor. In reply, HONI described its approach in fairly vague terms, stating that:

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[30] Exhibit C1, Tab 2, Schedule 5, Page 12
[31] Filing Requirements, Section 2.7.3.6
[32] IR 3.1-SIA-22
[33] Exhibit E1, Tab 1, Schedule 1, Page 1
[34] Exhibit C1, Tab 2, Schedule 5, Page 12. (Refer also to SIA TC Question #1)
[35] Exhibit A, Tab 4, Schedule1

> "The Z-Factor is a defined adjustment for use in IRM applications. Hydro One's application is a Custom application so Hydro One has proposed customized adjustments and materiality level to make the plan efficient and workable over the 5 test years."[36]

The SIA does not agree with HONI's assertion that the Z-Factor is limited to IRM applications, and does not understand why a Z-Factor would not be equally "workable" during the 5 test years. In the RRFE Report, the OEB is clear that the Z-Factor would continue to apply to all utilities, regardless of rate setting methodology:

> "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."[37]

Furthermore, in its recent EB-2012-0459 Enbridge Decision, the Board stated with regard to the Z-Factor that it "is appropriate to have similar criteria across all regulated entities to facilitate consistent outcomes in specific applications."[38] In light of this, and for reasons of consistency, the SIA strongly believes that the Board should reject the customized list of adjustments put forward by HONI, and apply the standard Z-Factor for the duration of the plan.

HONI has also proposed a higher (more restrictive) materiality threshold than that offered by the Z-Factor. Given this was proposed voluntarily by the applicant, the SIA does not believe that this higher threshold needs to be enforced via the Board's decision, as having made this argument it is unlikely that HONI would seek a Z-Factor for amounts it has claimed on record as immaterial. Accepting a higher threshold would create an anomaly to the standard policy concerning threshold calculations applicable to all other utilities, and disrupt the consistency that the Board has determined is important to maintain. However, should the Board decide that such a deviation is sufficiently minor, the SIA would certainly not oppose the higher threshold as proposed by HONI.

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[36] IR 2-SIA-20
[37] RRFE Report, page 13
[38] EB-2012-0459 Decision, page 19

Similarly, HONI has also identified two specific events that would trigger an off-ramp, in addition to the Board's standard adjustments: industry restructuring or a major change to HONI's service territory. The SIA believes that the current Board policy concerning off-ramps is sufficiently adequate, and that the events identified by HONI, if and when they occur, are so fundamental that they would by definition affect a large portion of the electricity distribution sector and therefore be appropriately addressed by the Board in due course.

Specific Service Charges:

As part of this application, HONI has proposed to continue to apply the service charge rates included in Schedule11-1 of the 2006 Distribution Rate Handbook ("DRH"). The Board's policy concerning specific service charges allows distributors to adopt and apply the standard charges listed in the DRH, or if circumstances warrant, apply for custom charges calculated using a standard formula.[39]

The SIA asked HONI if any analysis was performed as to whether the standard charges continue to be appropriate to its circumstances and in reflecting the principles of cost causality. HONI stated that the "charges are considered acceptable based on staff consideration of whether the charges reasonably reflect the cost of providing this service and the magnitude of the revenues generated from these services."[40]

The SIA further requested that HONI calculate the estimated actual cost of performing each service by using the Board's approved standard formula methodology (as included in Schedule 11-2 of the DRH), and updating for HONI's current actual vehicle and labour rates. Contrary to its earlier assertion that "the charges reasonably reflect the cost", the results of these calculations show a sizeable under-recovery of costs when using the standard charge amounts.[41] HONI itself agreed that if it were "to implement actual cost-based charges, revenues would increase significantly"[42]

[39] 2006 Electricity Distribution Rate Handbook, page 107
[40] IR 6.6-SIA-53
[41] IR 6.6-SIA-54
[42] IR 6.6-SIA-54

The under-recovery ranges from fifty percent in the case of installing a temporary connection, to as high as several hundred percent in the case of several after-hours services. HONI has forecast that from a revenue perspective the use of the standard service charges results in an ongoing under-recovery of approximately $4.0 million on annual basis.[43] If extended over the entire test year period, this could result in a revenue under-recovery of up to $20 million. The SIA submits that this is significant.

Of the $4.0 million value, approximately $3.0 million is as a result of a single charge, namely regular hour disconnections/reconnections, which are currently charged at a standard rate of $65, and which HONI estimates actually cost $185 to undertake.

The SIA submits that the Board should consider the extent to which such an under-recovery in HONI's specific service charges should be allowed to continue throughout the entire test year period. Given the urgent need for increased revenue to fund new capital and operating expenses as presented in this application, the SIA is surprised that HONI did not itself propose an updated set of service charges to help mitigate rate impacts and to properly reflect cost causality and cost recovery.

The SIA is particularly concerned that such an under-recovery not be extended for the duration of the 5 year period, and believes that an update to specific service charges presents a unique opportunity for additional revenue without the need to update base rates. Any increase to HONI's specific service charges would directly increase its revenue offsets and decrease its revenue requirement, lowering any potential bill impacts stemming from the Board's decision in this application.

As specific service charges generally reflect services provided at the request of customers (copies of bills, temporary service requests, etc) or as a direct result of the actions of customers (collections charges related to non-payment, etc), the SIA does not believe that continuing to

[43] IR 6.6-SIA-54

subsidize these charges is appropriate.   To the extent possible, the SIA believes that these charges should closely reflect their underlying costs.

The SIA respectfully urges the Board to order HONI to update its service charges based on its actual costs and incorporate the additional forecast revenue as part of rate finalization. If and/or when fully implemented, this would result in an additional $4.0 million in revenue offsets on an annual basis, or approximately $20 million over the 5 year term.

If the Board is concerned that a shift to full cost recovery would bring about too dramatic an increase to any particularly specific service charge, the SIA respectfully submits that it should at least order HONI to apply a partial percentage increase to each service charges (i.e. a certain reasonable percentage of the full increase), so as to narrow the gap between the charge and the actual cost of providing each service.

Alternatively, the SIA suggests that the Board consider ordering HONI to at least increase the Disconnect/Reconnect (regular hours) charge, as this charge on its own, just on account of the volume of incidents, is the cause of 75% (or $3M annually) of the revenue under-recovery. The Board could require HONI to increase this charge by whatever amount it deems reasonable, anywhere from the $65 currently applied (the Board's standard charge amount), to no higher than $185 – the actual cost of performing the service as calculated by HONI. While a reduced rate (from the fully costed amount) would necessarily reduce the potential revenue that could be collected, it will nonetheless reduce the under-recovery and partially increase revenue offsets by a material amount, with a corresponding decrease to revenue requirement resulting in lower bill impacts to all customers.

The SIA would also urge the Board to consider undertaking a generic review of these charges and publishing an updated list to that contained in the DRH. Given that the DRH was issued in 2006, the rates for the specific service charges are all presumably based on some industry data from 2005 or earlier. Given the passage of time, the SIA suspects that at present the costs to perform these services for most utilities would materially exceed the standard rates being charged for them.

Rate Smoothing:

HONI has proposed a rate smoothing concept as part of the implementation of any rate increases resulting from this application.[44] While the SIA believes that the need for a rate smoothing mechanism will depend on the rates (and rate increases) ultimately approved by the Board, given the generally modest rate impacts in any given year, the SIA does not believe that rate smoothing will be required in this case. As a general concept, and with the exception of particularly uneven cost cycles, the SIA believes in cost recovery being performed on a timely basis. As such, it does not believe that the added interest and carrying costs that customers would have to ultimately pay would justify the slightly more balanced recovery of costs through relatively more steady rate increases. Given additional changes to the electricity bill from expected changes in transmission and commodity rates, any efforts to provide rate smoothing for this distribution portion of the bill would likely go unnoticed and unappreciated by the vast majority of customers.

All of which is respectfully submitted.

[44] Exhibit F1, Tab2, Sch 1