

October 16, 2014

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

Dear Ms. Walli:

Re: Hydro One Networks Inc. 2015-2019 Custom Application – EB-2013-0416

Please find, attached, the Final Argument of the Consumers Council of Canada in the above-referenced proceeding.

Yours truly,

Julie E. Girvan

Julie E. Girvan

CC: Hydro One, Regulatory
Don Rogers, Rogers Moore
All Parties

FINAL ARGUMENT OF THE CONSUMERS COUNCIL OF CANADA
HYDRO ONE NETWORKS INC.
CUSTOM APPLICATION FOR DISTRIBUTION RATES – 2015-2019
EB-2013-0416

I. INTRODUCTION:

Hydro One Networks Inc. (“Hydro One”) filed an application on December 19, 2013, with the Ontario Energy Board (“Board”) for approval of distribution rates for a five-year period commencing January 1, 2015. Hydro One’s Application has been made pursuant to the Board’s Renewed Regulatory Framework For Electricity (“RRFE”).

Hydro One filed evidence in December 2013 that was updated on January 31, 2014. Following a series of technical conferences held in April 2014, Hydro One filed further updates and amended evidence. Another technical conference was held on July 21 and 22. The Board in Procedural Order No. 1 dated March 14, 2014, stated its expressed intent to hear, through an oral hearing process, issues that related specifically to the implementation of the Board’s RRFE policy. This was the first custom plan filed under the RRFE. A settlement conference was held on July 28, 2014 to deal with a limited set of issues, but a settlement was not reached. The oral hearing began on September 8 for seven hearing days, ending on September 18, 2014.

This is the final argument of the Consumers Council of Canada (“Council”) regarding Hydro One’s Application.

The Council acknowledges that the Board must assess the merits of Hydro One’s overall plan and the extent to which it is consistent or compliant with the Board’s RRFE policy. What is equally important, from the Council’s perspective, is that the Board consider whether Hydro One’s plan is consistent with the following Board objective as set out in the Ontario Energy Board Act:

1. To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service;

Compliance with the RRFE does not necessarily mean that a rate plan is in the best interests of a distributor’s ratepayers. Ultimately, the rates arising out of the plan must be just and reasonable, and it must be structured in a way that ensures that the risks to ratepayers are minimized throughout the plan term.

The Council will briefly describe the components of Hydro One's proposal and the requirements of the RRFE. The Council will then make submissions on Hydro One's proposal in the context of the RRFE framework and propose amendments that are required to ensure the interests of ratepayers are sufficiently protected. We will then make submissions on other elements of Hydro One's Application.

II. HYDRO ONE'S CUSTOM PROPOSAL:

Hydro One's has described its application as a five-year "Custom Cost of Service" application filed pursuant to the Board's new "Custom Rate-Setting Method". Hydro One's evidence is that it required a custom approach given its proposed significant and "necessary" multi-year investments with relative certain timing and levels of associated expenditures. It has been customized to fit Hydro One's specific circumstances (Ex. A/T4/S1/p.1). The major elements of the proposal are the following:

1. Revenue requirements for five years which include forecasts for capital and operating, maintenance and administration in each year;
2. "Annual Adjustments" for the cost of capital, changes in other third party pass through charges, working capital and the clearance of deferral and variance accounts;
3. Adjustments outside the "normal course of business" for unexpected events that materially impact the operation of the Company and outside of its control. This would include new government directives or legislation, material changes to codes and standards, or material unforeseen weather events (Ex. A/T4/S1/p. 4)
4. An "Off-Ramp" that would be initiated if the it performs outside of +/- 300 basis points earnings dead band or its performance erodes to unacceptable levels. Hydro One's proposal is to include that the off-ramp be triggered if there was industry restructuring of the distribution sector or a significant change to Hydro One's licensed service territory which would have a very significant impact on revenues and costs and would prevent continuing the plan (Ex. A/T4/S1/p. 5);
5. Eight "outcome metrics" which are for annual reporting. The measures are in the following areas:
 - a. Vegetation Management
 - b. Pole Replacement
 - c. PCB Line Equipment
 - d. Substation Refurbishment
 - e. Distribution Line Equipment Refurbishments
 - f. Customer Experience

- g. Handling of Unplanned Outages
- h. Estimated Bills (Ex. A/T4/S4/p. 5)

6. Annual Reporting (as set out in Exhibit J5.7); and

7. Rate smoothing over the term of the plan.

Hydro One's proposal results in an average revenue requirement increase of 10.5% in 2015, 7.3% in 2016, 2.9 % in 2017, 2.1 % in 2018 and 2.6%, although the proposed rate increases and bill increases vary for each of the various rate classes. Under Hydro One's smoothing proposal the average revenue requirement increase in each year is 6.3% (Tr. Vol. 1, pp. 22-23). For many customers, the increases are significantly higher (Ex. J3.3). Overall, Hydro One is seeking to recover from its customers an additional \$1.73 billion over the term of its plan (Tr. Vol. 1, p. 26).

It is important to note that Hydro One's proposed increases do not include changes in the other components of the bill. This would include changes in the commodity cost arising out of Ontario Power Generation Inc.'s application, changes in commodity costs as a result of increases in the level of renewable generation in the generation mix, increases arising out of the new Conservation First initiative, transmission cost increases etc. In assessing the bill impacts proposed by Hydro One, the Board must be mindful of the fact that ratepayers also be faced with increases arising out of these other components of the bill, that will continue over the term of the plan. Hydro One's proposals cannot be viewed in isolation of these other factors.

III. RENEWED REGULATORY FRAMEWORK:

On October 18, 2012, the Board released its Report entitled "Renewed Regulatory Framework for Electricity Distributors: A Performance Based Approach." ("RRFE Report"). In the RRFE Report the Board cited an evolving energy sector in Ontario and its intent to regulate the industry in a way that serves present and future customers, and better aligns the interests of customers and distributors while continuing to support that achievement of public policy objectives, and that places a greater focus on delivering value for money.

The Board has characterized the RRFE as "a comprehensive performance-based approach to regulation that is based on the achievement of outcomes that ensure that Ontario's electricity system provides value for money for customers." The framework is based on the following outcomes:

1. **Customer Focus:** services are provided in a manner that responds to identified customer preferences;

2. **Operational Effectiveness:** continuous improvement in productivity and cost performance is achieved; and utilities deliver on system reliability and quality objectives;
3. **Public Policy Responsiveness:** utilities deliver on obligations mandated by the government;
4. **Financial Performance:** financial viability is maintained; and savings from operational effectiveness are sustainable.

The Board established three alternative rate-setting methods for distributors and in doing so stated that it remains committed to the principles established in its 3rd Generation Incentive Regulation (“IR”) Report. All three methods are based on a multi-year IR mechanism.

With the new RRFE distributors are given a choice as to which model best meets its needs and circumstances. Among the three choices is the “Custom Incentive Rate-Setting Method” (“Custom IR”). In the RRFE Report, the Board described the Custom IR approach in the following way:

- 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 the specifics of how the costs approved by the Board will be recovered through the over the term will be determined in individual rate applications. The rate-setting method is intended to be customized to fit the specific applicant’s circumstances;
- The Customized IR method will be the most appropriate for distributors with significantly large multi-year or highly variable investment commitments that exceed historical levels. The Board expects that a distributor that applies under this method will file robust evidence of its costs and revenue forecasts over a five-year horizon. In addition, the Board expects a distributor’s application under Custom IR to demonstrate its ability to manage within the rates set, given that actual costs and revenues will vary from forecast.
- The Board has determined that a minimum term of five years is appropriate. As is the case for 4th Generation IR, this term will better align rate-setting and distributor planning, strengthen efficiency incentives and support innovation. It will help manage the pace of rate increases for customers through adjustments calculated to smooth the impact of forecasted expenditures.

- The allowed range in the rates over the term will be determined by the Board on a case-by-basis informed by empirical evidence including: the distributor's forecasts (revenues and costs including inflation and productivity); the Board's inflation and productivity analyses; and benchmarking to assess the reasonableness of the distributor forecasts.
- Under Custom IR, planned capital is expected to be an important element of the rates distributors will be seeking, and hence subject to thorough reviews by parties to the proceeding. Once the rates have been approved, the Board will monitor capital spending against the approved plan by requiring distributors to report annually on actual amounts spent. If actual spending is significantly different from the level reflected in a distributor's plan, the Board will investigate the matter and could, if necessary, terminate the distributor's rate-setting method. (RRFE Report, pp. 18-19)

The Board made a number of further conclusions throughout the RRFE Report which are relevant to assessing the development and implementation of Hydro One's Custom IR plan (emphasis added):

- The Board has concluded that it will maintain its current policy with respect to rate mitigation (a consideration of rate mitigation is required if total bill increases for a class exceed 10%). The Board further concludes that it is not necessary to limit the mitigation mechanisms that distributors may want to propose. The Board will continue to evaluate proposed mechanisms on a case-by-case basis;
- With respect to capital planning the Board concludes that a planning horizon of five years is required to support integrated planning and better align distributor planning cycles with rate-setting cycles. This time horizon along with the integrated approach to planning will allow distributors to pace and prioritize projects with a view to the impact on total bill for customer. This planning horizon should also enhance cost predictability for both the distributor and its customers (RRFE Report, p. 31-32);
- Pacing and prioritization of capital investments to promote predictability in rates and affordability for customers must be a primary goal in a distributor's capital plan (RRFE Report, p. 37). A distributor must exercise control over the pace of its own capital spending, as this factor can be an important element in the total cost of electricity to consumers. To aid distributors in this essential task, standardized methods and tools should be developed for use by distributors in the preparation of their plans. In addition, the Board sees merit in receiving the evidence of third party experts as part of a distributor's application, or retaining its own third party experts, in relation to the review and assessment of distribution asset management and network investment plans (RRFE Report, p. 37);

- Benchmarking will become increasingly important, as comparisons among distributors is one means of analyzing whether a given distributor is as efficient as possible. The Board concludes that benchmarking models will continue to inform rate setting (RRFE Report, p. 56 and 60);
- The Board concludes that a scorecard will be used to monitor individual distributor performance and to compare performance across the distribution sector (RRFE Report, p. 57).

Since the RRFE Report was issued the Board has undertaken, in conjunction with stakeholders and consultants, further work including work regarding regional planning, smart grid investments, the development of a scorecard and implementation issues. The fundamentals of the RRFE as set out above have not changed. It is within this context that Hydro One's Custom application must be assessed.

The Council will first make submissions on why it is of the view that Hydro One's five year proposal is not consistent with incentive regulation and why it does not meet many of the Board's expectations as set out in the RRFE. The Council will then propose adjustments to the plan to better align the interests and balance the risks between Hydro One's ratepayers and shareholders. The Council will then deal with the following issues specific to Hydro One's application:

1. Rate Base and Capital
2. Operations, Maintenance and Administration Costs
3. Economic and Load Forecasts
4. Cost Allocation and Variance Accounts
5. Deferral and Variance Accounts

IV. INCENTIVE REGULATION AND THE RRFE:

Throughout the Board's RRFE Report (as described and highlighted above) a number of key requirements and themes emerge:

1. The rate-setting plans are to be "incentive", performance based plans. A Custom IR must include robust evidence in support of the cost and revenue forecast and the utility must manage, during the term of the plan with the rates that have been set;
2. The proposed rates should be informed by empirical evidence regarding productivity and inflation;
3. Benchmarking will continue to be important in terms of informing a plan and assessing efficiency and performance relative to other distributors;
4. Capital plans must involve pacing and prioritization;

5. There is merit in obtaining third-party experts to assess asset management and network investment.

From the Council's perspective, the Hydro One application is not consistent with the RRFE and falls short of meeting the RRFE requirements for reasons set out below. The Council had reviewed the comprehensive submissions of Board Staff regarding the RRFE objectives and is, in large measure in support of those submissions and proposals.

1. Incentive Regulation

Hydro One's application is not an "incentive" regulation plan. It is essentially a five-year cost of service application without incentives in place to drive efficiencies. Unlike cost of service, however, Hydro One's plan has a number of annual adjustments for recurring events (e.g. cost of capital) and events "outside the normal course of business" that would materially impact to the operation of the utility (Ex. A/T4/S1/p. 4). The open-ended nature of the adjustments are not consistent with the Board's intent to have utilities manage within the rates set over the term of the plan or with how rates would be set under a cost of service approach. In addition, having effectively a cost of service approach with a variety of adjustments reduces Hydro One's risks over the term of the plan.

Hydro One has been unequivocal throughout this proceeding that is seeking approval for a "Custom Cost of Service" application under the Board's new "Custom Rate-Setting " method (E. A/T4/S1/p. 1). Board Staff, in its submission has clearly stated, "Staff does not believe that it is the Board's policy intent that Custom IR be equivalent to cost of service, rate of return rate setting" (Board Staff Submission, p. 7).

What is lacking under Hydro One's plan are incentives. Under a typical performance based approach to rate-making a utility should be incentivized to find sustainable efficiency gains throughout the term of the plan. There is nothing in Hydro One's plan that encourages this.

Under Hydro One's proposal, it is asking the Board to approve projected costs and revenue forecasts for a five-year period. Those forecasts, given they are for a five-year period will be wrong, or not reflective of what Hydro will actually be spending over the plan term. Yet Hydro One has not proposed any ratepayer protection mechanisms in the event they are wrong. The most obvious incentive for Hydro One is to spend less on capital and OM&A in order to enhance its returns. Under Hydro One's model there are no clear incentives to pursue long-term sustainable productivity initiatives that will ultimately benefit its customers.

Hydro One has mechanisms in place that will protect its shareholders if the rates are insufficient to protect it against unforeseen events. Those annual adjustments typically work in favour of the utility because of information asymmetry. An

unforeseen cost impact can be brought forward by the utility and recovery of those costs, if prudent, is sought. If there is an unforeseen event, like a change in regulation for example, that reduces costs for the utility, it is unlikely it will be brought forward as a credit to ratepayers.

2. Productivity

The Board's expectation was the rate levels proposed would be determined by the Board on a case-by-case basis informed by empirical evidence including the Board's inflation and productivity analyses and benchmarking to assess the reasonableness of the distributor's forecasts. Hydro One has not provided that empirical evidence. With respect to productivity Hydro One filed evidence regarding cost efficiencies and productivity. That evidence did not set out an explicit X factor or stretch factor.

Hydro One's approach has been to produce forecasts of its costs for the 2015-2019 period. Its position is that it has built in the savings that it expects to achieve over the term of the plan (Tr. Vol. 1, pp. 46-47). However, it is clear from the evidence that Hydro One's proposed "savings" for the plan period of \$728 million have been overstated, based on historical initiatives and are in large measure not incremental.

Exhibit 2.03/VECC 42 sets out a detailed derivation of Hydro One's productivity savings for the period 2013 to 2019. Looking at the Cornerstone Project which has been completed Hydro One is claiming savings in 2015 of \$30.762 million. Yet Cornerstone is a project that is completed and in place. The costs associated with Cornerstone are the costs currently part of what it takes today to operate the business. Cornerstone may have brought efficiencies relative to the way the business was operated before, but it depends on the baseline. In this case the baseline is 2014. In the VECC interrogatory the incremental savings associated with Cornerstone are \$180,000 in 2015, not \$30.762 million.

Another example of how Hydro One's savings analysis is flawed is to look the example of "feller bunchers" a technology that significantly increases the efficiency of clearing trees. Hydro One has six in use today and the savings in 2014 relative to prior periods is \$3 million. Purchasing four more would mean savings in 2015 of \$1.5 million and not \$4.5 million which are the savings set out in the summary table. Hydro One agreed that the incremental savings associated with this technology should be characterized as \$1.5 million and not the \$4.5 million set out in the savings table (Tr. Vol. 4, p. 14).

Hydro One's evidence is that it expects "savings" for the period 2014-2019 of \$728.8 million (Ex. A/T19/S1/p. 4). The Council submits that given most of these "savings" are the result of previous initiatives, there is very little in terms of savings forecast for the test year period. Incentive regulation is structured so utilities are incented to find new, incremental efficiencies to enhance its operations and bring value to its customers. Hydro One's proposal will not accomplish that.

During the proceeding Hydro One was asked to calculate a productivity factor based on its projected incremental savings that it expected over the plan. The result of the calculations was .29% (Ex. J4.2). Clearly, Hydro One's plan is not a performance based approach that will benefit its customers.

3. Benchmarking

Hydro One has not, in support of its plan filed, any total benchmarking studies or benchmarking studies regarding its capital or OM&A costs (Tr. Vol. 1, pp. 31-33). The only benchmarking that Hydro One has undertaken was described at the hearing. Hydro One undertook a 2011 compensation study in 2011 that was updated in 2013. There was a review undertaken to look at the arrangements between Hydro One and Hydro One Telecom. Two other historical reports looked at vegetation management and the outsourcing arrangement with Inergi (Tr. Vol. 1, p. 32).

The Board has stressed that benchmarking is an integral part of the RRFE and will continue to be used to assess distributor performance. Hydro One's evidence is that "no external or internal benchmarking studies have been undertaken to estimate the productivity gains that will be achieved during the term of the plan" (Ex. 1/T2/2.06/Staff 33).

Board Staff has highlighted in its submissions the fact that benchmarking provides a meaningful comparison with other utilities and is critical in terms of providing the Board with a basis for assessing the reasonableness of forecasts underpinning Custom IR application (Staff Submissions, p. 24). As noted in the RRFE benchmarking is also useful in assessing the extent to which a distributor is improving during the term of plan. It is Hydro One's position that benchmarking is a difficult exercise, as there are few comparators to Hydro One. The benefits of benchmarking are really limited to identifying best practices (Tr. Vol. 1, p. 40-42).

4. Capital Planning with Prioritization and Pacing

The Board has placed an increased emphasis on capital planning as part of the RRFE and the importance of pacing that capital. The Board also saw merit in the use of third party experts to assess distribution asset management and network investment plans, but Hydro One did not provide that evidence.

Hydro One has proposed capital expenditures based on its Distribution System Plan. Hydro One has developed its capital plan on the basis of prioritization and pace, which ultimately affects the proposed level of rates. The Board has stressed the need for pace. Hydro One, however, is prepared to move off that pace if it finds efficiencies and cost savings during the five-year plan. Rather than sharing those savings with customers through an earnings sharing mechanism, Hydro One's proposal is to accelerate the pace of its programs (Tr. Vol. 22, pp. 113-114). Having

carefully established a capital plan based on a certain pace, Hydro One may move off that pace. All that does is deprive customers a benefit from savings generated during the plan and increases the rate base going forward. The Council submits that once a pace for capital investment has been proposed on the basis of careful prioritization, and having regard to rate impacts, it would not be in the interests of Hydro One's customers to effectively re-invest productivity savings rather than sharing those savings with the customers.

V. PLAN COMPONENTS:

1. Annual Adjustments:

As part of its proposal Hydro One is requesting approval of a set of annual adjustments as a safeguard to protect both the Company and its customers against unexpected results in the operation of the plan.

The first set of adjustments is for "recurring events that are mechanical in nature". The adjustment will be done based on year-end audited financial statements or parameters issued by the Board or the Federal or Provincial Government (Ex. A/T4/S2/p. 1). Under Hydro One's proposal these adjustments would be mechanical in nature and would not require a prudence review.

The first such adjustment is the cost of capital and this would require two components. Hydro One proposes to update both its debt costs (based on any new debt issues) and its return on equity based on the Board's annual numbers. This is consistent with past practice and with what has recently been approved for Enbridge Gas Distribution. The Council accepts this as an appropriate adjustment. The Council is of the view that consistent treatment for the cost of capital across utilities is a sensible approach.

2. Adjustments Outside the Normal Course

Hydro One has proposed adjustments outside the "normal course of business" for unexpected events that materially impact the operation of the Company and outside of its control. This would include new government directives or legislation, material changes to codes and standards, or material unforeseen weather events (Ex. A/T4/S1/p. 4).

The Council is generally supportive of allowing for such adjustments to be part of Hydro One's plan. As noted by Board Staff the examples given are consistent with the Board policy for Z-factors established under the 3rd Generation IRM. What is critical, however, is any application for approval of such an adjustment must be accompanied with robust evidence explaining why the "event" is outside the normal course of business, outside of the Company's control and material. It is also important to ensure that these adjustments are symmetrical.

3. Off Ramp

Under Hydro One's proposal an "Off-Ramp" would be initiated if the Hydro One performs outside of +/- 300 basis points earnings dead band, or if its performance erodes to unacceptable levels. Hydro One's proposal is to include that the off-ramp be triggered if there was industry restructuring of the distribution sector or a significant change to Hydro One's licensed service territory which would have a very significant impact on revenues and costs and would prevent continuing the plan (Ex. A/T4/S1/p. 5).

The Council supports the inclusion of an off-ramp as it is a standard component of any rate-making plan.

4. Outcome Metrics/Annual Reporting

Hydro One proposed eight "outcome metrics" which are for annual reporting. The measures are in the following areas:

- a. Vegetation Management
- b. Pole Replacement
- c. PCB Line Equipment
- d. Substation Refurbishment
- e. Distribution Line Equipment Refurbishments
- f. Customer Experience
- g. Handling of Unplanned Outages
- h. Estimated Bills (Ex. A/T4/S4/p. 5)

The Council submits that it is important during any incentive regulation plan to have performance metrics. These are important, in large measure to ensure that service does not degrade, and that the regulator has information regarding performance of the utility during the term of the plan. From the Council's perspective it is important that reporting be meaningful and useful for both the regulator and stakeholders. It is particularly important that utilities are not required to report on things that will be of limited value. There were many comments made in this proceeding about the value of the metrics proposed by Hydro One and how meaningful they might be without any consequences associated with not meeting targets. There were also suggested additions to Hydro One's proposed list.

Hydro One committed during the hearing process to a number of further reporting requirements over and above those already prescribed by the Board, or set out in its Application.

If Hydro One's proposals for a five-year custom rate-setting plan are accepted by the Board, with or without amendments, it will be important for a meaningful reporting scheme to be established. The Council suggests that in light of the way Hydro One's proposals have evolved, that further work is required to land on the "right"

reporting. This would include outcome metrics, scorecards and other information required by the Board and/or intervenors to monitor and assess Hydro One's performance during the plan. For example, if an ESM is established by the Board the mechanics of the ESM would need to be resolved. It would also be important to include reporting that would be useful when the plan is terminated upon rebasing.

The Council suggests that the Board require Hydro One to meet with Board Staff and intervenors with a goal of establishing a complete set of reporting requirements that would be put in place for the duration of the plan. The reporting requirements would be subject to Board approval. From the Council's perspective this would be a practical approach in order to land on the "right " reporting rather than relying on the argument process. To the extent there was disagreement the Board could assess the relative positions on the issues and rule on what the final reporting requirements should be.

5. Rate Smoothing:

Hydro One's Application involves rate-smoothing primarily to mitigate the impact of what would otherwise be a significant rate impact in 2015. That rate impact is driven in large measure by in-service additions during the 2012-2014 period that have not been added to rate base.

The Council is supportive of rate smoothing as it provides less bill volatility for customers. Having said that it is important that the "full story" be told. In terms of customer notification regarding the outcome of this plan and the resulting rates, Hydro One should be required to tell its customers what increases it is proposing in each year and how it intends to smooth those increases over the five-year period. Otherwise, it simply masks the overall request.

VI. PROPOSED ADJUSTMENTS TO THE PLAN:

The Board has expressed a desire for rate-setting plans under the RRFE to better align interests of customers and distributors while continuing to support that achievement of public policy objectives, and that places a greater focus on delivering value for money. Hydro One's proposal does not result in an appropriate balance between the interests of the ratepayers and the shareholder particularly in light of the absence of any ratepayer protection mechanisms

Hydro One's plan has a number of deficiencies, as discussed above. The way the plan is structured there are no incentives to find long-term sustainable efficiency gains. Hydro One has not provided empirical evidence regarding inflation or productivity. The absence of external benchmarking or external consulting reports to assess Hydro One's budgets is troubling given the Board's expectations set out in the RRFE.

The Board could reject Hydro One's proposal given it really a "dressed up" form of cost service regulation that is balanced in favour of the shareholder, and not what was expected by the Board according to the RRFE. The Board could also limit the term of the plan. From the Council's perspective the Board should approve the overall structure of the plan, but require a number of adjustments to establish a better balance between the interests of Hydro One's shareholders and ratepayers. As noted above, whether a utility is "compliant" with the expectations of the RRFE, does not necessarily mean a plan should be approved. At the end of the day the Board must ensure that it is protecting the interests of ratepayers with respect to prices and the adequacy, quality and reliability of electricity service.

It is only with the appropriate amendments that the Application should be approved. The Council submits that the Board should impose a stretch factor for Hydro One, implement an Earning Sharing Mechanism, and mandate total cost benchmarking to be undertaken over the next five years.

1. Stretch Factor

Board Staff has proposed a stretch factor of 1% in order to reflect incremental efficiency gains over the term of the plan. The Council submits that in the absence of explicit productivity being built in the plan (other than those that are simply historical initiatives) imposing a stretch factor is essential. The Council supports Board Staff's proposal.

2. Earning Sharing Mechanism

An Earnings Sharing Mechanism ("ESM") is a tool that provides for benefit sharing between ratepayers and shareholders if the Company earns more than its allowed return during the IR term. The Board in the most recent Enbridge Gas Distribution ("EGD") proceeding for a custom plan approved an Earnings Sharing Mechanism for EGD. The Board concluded that the lack of total cost benchmarking and the lack of independent budget assessments result in a greater risk that costs have been over-forecast and that additional (Decision with Reasons, EB-2012-0459, p. 15).

Hydro One was reluctant to adopt an ESM despite the fact that during its stakeholders sessions undertaken in developing the plan, many ratepayer groups were in favour of it. Hydro One's position was based on the following:

- a) Hydro One has proposed smoothing which is an alternative to an ESM;
- b) Hydro One has a history of underearning and therefore an ESM is not necessary;
- c) An ESM is simply too complicated. (Tr. Vol. 2, pp. 90-92)

The Council submits that smoothing and and ESM are not mutually exclusive. Smoothing takes the five years of revenue requirements and spreads their recovery over the term of the plan. An ESM ensures that any underspending relative to

forecast is refunded to customers. It also ensures that efficiency gains generated during the plan are shared with customers.

Although Hydro One has a history of underearning, that may not be the case in the future. In addition, the Board should reject Hydro One's proposal to apply any efficiency gains to increase the pace of its capital projects. Any efficiency gains generated during the plan should be shared with ratepayers and an ESM facilitates this.

Although Hydro One claimed that an ESM was simply too difficult to do, it provided an undertaking, as directed by the Board setting out a proposal. Although under a smoothing scenario an ESM may be somewhat more complicated than under a non-smoothed approach clearly it can be done. The Council submits that Hydro One should adopt an ESM on the same basis as the one the Board mandated in the recent EGD Decision. The EGD ESM shares over-earnings on a 50:50 basis between ratepayers and shareholders.

3. Benchmarking

Board Staff has made a number of submissions regarding benchmarking. The Council is supportive of those submissions which would require Hydro One to undertake total cost benchmarking studies over the next five years to establish an empirical baseline for Hydro One's performance and provide an empirical foundation for Hydro One's next application. The Council notes that benchmarking is both a requirement under the RRFE and a requirement established by Hydro One's shareholder under the Memorandum of Agreement between Hydro One and the Province. (Ex. I/1.01/CCC 3/Attachment 2).

4. Monitoring and Reporting

If the Board approves a five year plan for Hydro One annual monitoring and reporting will be critical in terms of assessing Hydro One's performance during the plan and for the purposes of setting rates at the end of the plan. As set out above Council supports a process whereby Board Staff, Hydro One and intervenors, with Board guidance arising out of the evidence in this proceeding, collaborate on what monitoring and reporting would be most meaningful. The Council sees no value in requiring Hydro One to report data, results and metrics unless it is clear how it will be used. A collaborative approach would, from the Council's perspective be the most practical.

VII. RATE BASE AND CAPITAL:

One of the most significant drivers of Hydro One's rate increases is related to capital spending. The impacts are generated from capital spending undertaken over the past several years and capital spending over the five year term of the plan.

The Association of Major Power Producers in Ontario (“AMPCO”) has made submissions regarding Hydro One’s Sustaining Capital program. The Council has reviewed those submissions and supports them. AMPCO is suggesting a number of reductions regarding Hydro One’s expenditures based on the fact that Hydro One has not justified its increased pace in many areas (Transformer Spares, Station Transformers, Station Refurbishments and Pole Replacements) in terms of increased reliability or delivering other benefits to its customers.

In addition, the School Energy Coalition made a number of submissions regarding Hydro One’s Smart Grid Expenditures. The Council agrees with SEC that until Hydro One has honored its commitment to track and monitor Smart Grid expenditures and file a proposal on how best to report upon the progress and results of its Smart Grid program, which was a commitment in the EB-2013-0141 proceeding, recovery of those expenditures should be denied.

The Council, has been concerned for many years that Hydro One is spending a considerable amount of money on Smart Grid, without a clear understanding of how those expenditures provide value and cost savings. That was the reason for seeking the commitment in the last proceeding. To date Hydro One has not demonstrated that its Smart Grid expenditures provide its customers with benefits that outweigh the costs.

VIII. OPERATIONS, MAINTENANCE AND ADMINISTRATION COSTS:

The Council has proposed a stretch factor for Hydro One that will ultimately reduce the allowed revenue requirement. In addition, the Council has challenged Hydro One’s claims that embedded in its forecasts are \$778 million worth of productivity savings. Hydro One’s OM&A forecast is simply a forecast of what it expects its costs to be over the five year period and nothing more.

The Council is concerned about two specific components of OM&A and the level of increases proposed in the test period – Vegetation Management and Compensation.

With respect to Vegetation Management we have reviewed the comprehensive submissions made by AMPCO. AMPCO provides a critique of Hydro One’s Vegetation Management program citing declining productivity and argues that the proposed ramping of the program has not been justified. Hydro One has not justified that it can cost-effectively achieved its proposed targets. Accordingly, the level of Vegetation Management should not be accelerated in 2016 and 2017, but rather be maintained at the eight year cycle. This would result in \$72 million reduction over the five year period.

With respect to compensation the Board has made reductions to Hydro One’s costs in each of the last cost of service proceedings based on the fact that Hydro One’s compensation costs remain excessive in comparison to market indicators.

In this case Hydro One filed an updated Mercer Study which shows some improvement over previous years as compared to an industry benchmark, but demonstrates that Hydro One's compensation remains well above the market median (Ex. C1.T3/S2/Attachment 2). The Council submits that Hydro One should be held to the market median. This would result in a reduction in OM&A of \$15.38 million per year (Ex. J3.12).

IX. ECONOMIC AND LOAD FORECASTS:

The Council has reviewed the submissions of the Vulnerable Energy Consumers Coalition ("VECC") with respect to Hydro One's load forecast. The Council supports those submissions.

VECC has made a number of suggestions regarding Hydro One's conservation and demand management ("CDM") adjustments to its load forecast. With respect to historical CDM savings Hydro One has not adequately tracked the difference between forecast and actual CDM as directed by the Board. VECC has also proposed downward adjustments for Hydro One's CDM forecasts going forward based on the new CDM Framework. The Council urges the Board to accept the adjustments proposed by VECC as they are consistent with the most recent targets for Hydro One as set by the Ontario Power Authority.

X. COST ALLOCATION AND RATE DESIGN:

Hydro One, in this case, has followed the Board's cost allocation policies approved on March 31, 2011. The Board's Report entitled, "Review of Electricity Distribution Cost Allocation Policy" was the result of a consultation process established to review earlier Board-approved policies. The proposals in this case are also consistent with the Board's Filing Requirements for Distribution Rate Applications issued July 17, 2013 (Ex. G1/T1/S1/p. 1).

Hydro One is also making a number of other changes with respect to cost allocation and rate design. With respect to rate classification Hydro One is adding a new Unmetered Scattered Load ("USL") rate class, changing the definition of its Seasonal Customer Class and incorporating the results of a rate class review across the all of Hydro One's service territory to ensure that all customers are classified in accordance with the currently approved density-based rate classifications. All of these initiatives were the result of Board directives, or commitments made through previous settlement agreements.

In addition, Hydro One is proposing to move the revenue to cost ratio ("R/C") for all of its rate classes to within the range of 98% to 102% over the five year term (2015-2019)(Ex. G1/T1/ S1/p. 1). With respect to rate design Hydro One is proposing to increase the amount of revenue collected through its fixed charges over the five year term.

1. Customer Classification

In Hydro One's 2013 IR application, Hydro One committed in the Settlement Agreement to review its customer rate classification to ensure that all customers were classified in accordance with its currently approved density based classes. B The rate class review resulted in 11% of Hydro One's customers being reclassified, with the majority of those moving to a higher density class with lower rates (Ex. G1/T2/S1p. 2). The net impact of the rate class review is a reduction of \$40 million on revenue at current rates. This results in a 3.4% average across all rate classes to make up for the deficiency given 11% of the customer base is moving to classes with lower rates (Ex. G1/T2/S1/p. 3). It is Hydro One's plan to update the customer class review every five years.

Board Staff has suggested that Hydro One update the customer classification more frequently and the Council supports this approach.

2. Seasonal Rate Class Review

In Hydro One's 2012 IRM Application the parties came to a settlement agreement. As part of that agreement Hydro One committed to consulting with stakeholders to review the rates for Hydro One's Seasonal customers. The intent of the review was to ensure that Seasonal Rates were fair and equitable and in accordance with rate-making principles (Ex. G1/T2/S1/p. 5).

Hydro One raised the issue of Seasonal rates at several of its stakeholder sessions that it undertook while developing its Custom plan. Hydro One also engaged the consulting firm Citizen Optimum to conduct a series of focus groups with Seasonal customers. Citizen Optimum produced a report on the focus group findings. The focus groups were used to gather participant opinions on fair rate designs for Seasonal customers and to solicit and present options for revising the Seasonal rate structure. (Ex. G1/T2/S1/p. 5).

As a result of the focus group process Hydro One proposes to move approximately 11,000 Seasonal customers (7% of the total Seasonal customers) to the medium density (R1) and low density (R2) rate classes. The customers must have an annual load of at least 9,600 kWhs per year, consume at least 600 kWhs monthly for a minimum of 10 months of the year. The net impact of the change is a drop in \$7 million in revenue at current rates. Those Seasonal customers moving to the year-round residential classes will see lower bills (resulting from lower rates) and all other customer classes will experience an average increase of .5% to make up for the revenue deficiency resulting from this proposed change (Ex. G1/T2/S1/p. 6).

It is Hydro One's position that its consultation efforts and proposed changes to the definition of the Seasonal class, combined with its proposals to increase the Seasonal fixed charges satisfies the commitment made in the previous Settlement

Agreement. The Council does not agree. The Federation of Cottagers' Associations has criticized the process, as have other representing other seasonal customers. The results of the focus groups should not be taken as the voice of seasonal customers across the Province. These are complicated rate issues that are difficult for customers to understand and difficult to resolve. Basing its proposal on the fact that this was the "preferred choice" among the focus group participants is not reasonable.

Hydro One has identified two primary reasons for making the changes to the Seasonal rate class. The first is to "better align with cost causality and fairness principles". The second reason is to address feedback from customers concerned about the disparity of rates between permanent and seasonal customers in the same area, on the same lake, and along the same road or on the same power lines (Ex. G1/T2/S2/p. 7).

Through the various consultation processes, and given the evidence adduced in this hearing, it became clear that there are a number of problems with Hydro One's existing Seasonal class and the criteria used to determine who is deemed Seasonal. Unlike other classes, a Seasonal customer is defined as such based on residency. Residential customers are deemed residential if they represent and warrant to Hydro One that they have year round residential status for the identified dwelling and they will not designate another property as year-round residence for the purposes of Hydro One's rate classification (Tr. Vol 6, p. 52). The occupant must live in the residence for at least four days of the week for eight months of the year and must not reside anywhere else for more than three days a week during eight months of the year. Documents such as a drivers licence, credit card invoices and property tax bills must have the address of residence on them. In addition, an occupant must be enumerated at the address for Provincial and Federal elections. (Ex. G2/T2/S1/p. 2). Those customers that cannot meet these criteria are deemed "Seasonal" and subject to rates under the Hydro One Seasonal rate tariff.

All customers in Hydro One's R2 class are all eligible for Rural and Remote Rate Protection ("RRRP"), a subsidy established through Ontario Regulation 442/01 for "residences that are continuously occupied for at least eight months of the year."

Hydro One admitted that there are customers in the residential classes that would not meet the residential criteria like those spending 6 months every year in Florida, but are deemed residential and, if part of the R2 class receive RRRP (Tr. Vol. 6, p. 120). Essentially the line between who is Seasonal and who is not is not based on a rules that are not always strictly enforced.

The inequity (and the subject of many complaints from customers) is that there are situations where customers in close proximity to each other, being served by essentially the same Hydro One assets, with comparable annual loads are not paying the same rates. The Seasonal customers in this scenario are paying more on an annual basis for the same amount of electricity.

Typically, however, seasonal customers may use the same amount of electricity as their “residential” neighbors in certain months, but during a large portion of the year, they use little or no electricity. The evidence is that the load profiles for seasonal customers are, in large measure different from residential customers (Ex. J6.3). As stated by Hydro One’s witness in the hearing the reason, you group seasonal customers into one class is because their underlying consumption and load profile are different than the other rate classes. (Tr. Vol. 6, p 92).

Another problem is that there are cross-subsidies within the Seasonal class. Those in low density areas are being subsidized by those in high density areas as the assets used to service low density customers are more costly (longer lines, more poles etc.). Higher volume Seasonal customers are subsidizing lower volume Seasonal customers as well.

Hydro One’s proposal with respect to Seasonal rates is to move 11,000 customers out of the Seasonal class because these customers have annual consumption and monthly load profile characteristics very similar to that of year-round customers (Ex. G1/T2/S1/p. 6). They are also proposing that even if these are seasonal residences these customers will receive RRRP, which is funded by all other customers in the Province.

Hydro One believes that this proposal is most responsive to the problems identified regarding its current Seasonal class. In addition, Hydro One has decided to propose this change on the basis of the focus group study undertaken by its consultant. Hydro One has not questioned the customers they propose to move into R2 as to whether or not they occupy the premises for at least months of the year, a qualification for RRRP (Tr. Vol. 6, p. 9). These customers are Seasonal, but their consumption pattern is similar to a year-round customer. They claim administrative ease as the reason for not prohibiting them from getting RRRP and agree it is “somewhat stretching the definition in the regulation” (Tr. Vol. 6, p. 10).

The Council agrees that there are a number of options that could be implemented to deal with the many issues and concerns identified regarding Hydro One’s Seasonal Class:

1. Hydro One could proceed with its proposal to move the 11,000 customers into R1 and R2

Hydro One should not proceed with this proposal on the basis that this is the “preferred choice” of all seasonal customers. The focus groups process provided some limited input, but should not be construed as a comprehensive “yes” vote for Hydro one’s proposal. This solution does not address what have been expressed as the primary concerns with the Seasonal class – criteria based on occupancy, cross-subsidies within the class, and unfairness for related to similar situated customers

paying significantly different rates. It also increases the rates for Seasonal customers.

In addition, this proposal Hydro One is creating a low-volume seasonal class, which may, in fact, exacerbate the issues identified above. It is also unclear why, under this proposal, these higher volume customers (those moving to R2) should be receiving a Provincial subsidy.

2. Hydro One could take the existing Seasonal Class and divide it into two density based classes – as was in place in previous years (R3 and R4), but revised during the rate harmonization implementation

This proposal would address one of the primary concerns with the existing structure – cross subsidization within the class. Prior to 2008 there was a distinction between seasonal customers in a small-town environment and those in the low-density areas. Hydro One's reluctance to go back to this is that it is trying to reduce the number of rate classes (Tr. Vol. 6, p. 139). That is not a legitimate concern from the Council's perspective as Hydro One is seeking approval to create a new USL class in this case.

3. Hydro One could eliminate the Seasonal Class and move all Seasonal Customers into the other residential rate classes – UR, R1 and R2;

Eliminating the seasonal class imposes costs on the other classes (Tr. Vol. 6, p. 125). In addition, low volume customers in the seasonal class would see a large increase. If this was the right answer, clearly mitigation could be considered.

4. Hydro One could maintain the status quo.

Maintaining the status quo does nothing to resolve the current issues associated with Seasonal rates – criteria based on occupancy, cross-subsidization within the class and fairness among like customers.

Class rate-making is a complicated exercise. No matter where you land, there is some level of inequity embedded in any rate structure. The concerns raised over the past few years are legitimate and difficult to resolve. Overall, the Council believes as a matter of principle that the solution must be one that is fair to all of Hydro One's customers and be focused on cost causality to the extent possible.

The Council submits that Hydro One's proposal should be rejected at this time as it does not solve any of the key issues inherent in the Seasonal rate structure. The impacts of moving back to a density based Seasonal Rates are not known at this time. In addition, the full impacts of eliminating the Seasonal class altogether are not fully understood. The Council submits that Hydro One should be required to retain an independent consultant to explore which of these two options would be in the best interests of all of Hydro One's customers. The study should analyze load

profiles and consider potentially different rate designs for the Seasonal customers. This may lead to an elimination of the class, a redesign or the introduction of additional Seasonal classes based on density, load profiles or consumption.

One of the problems Hydro One has encountered are complaints from Seasonal customers that do not understand how their rates are structured and the fact that fixed costs do not vary with consumption. Hydro One should be encouraged to undertake more comprehensive customer education regarding these issues.

3. Tightening the Revenue to Cost Ratios:

Hydro One intends to move the R/C ratios to 98 to 102 by the end of the five years. The Council supports the submissions made by VECC on this point, that is that 95% to 105% is a more reasonable approach. It represents a range typically used in other jurisdictions and recognizes that cost allocation methodologies are never a truly precise indication of costs.

4. Mitigation

The Board has a long-standing policy regarding mitigation urging distributors to undertake mitigation when total bill impacts exceed 10%. In the RRFE Report the Board expressed its intent to maintain that policy, and also accepted that distributors could propose alternatives that would be assessed on a case-by-case basis.

The Council is concerned that although, on average most customers will not have bill impacts that exceed 10 %, within some rate classes there may be outliers. Hydro One has acknowledged that is the case Hydro One has no plans to date to implement mitigation for these customers given the outcome of its application has not been determined by the Board (Tr. Vol. 6, pp. 40-41). Hydro one should be required to work with the “outliers” to ensure that they are not faced with unacceptable rate shock arising out of this application.

XII. DEFERRAL AND VARIANCE ACCOUNTS:

Hydro One is seeking recovery of \$445.1 million in smart meter capital costs and \$59.4 million in OM&A costs for the period 2009-2014 (Tr. Vol. 3, pp. 6-7). Board Staff has provided an analysis which indicates that these smart meter costs are significantly higher than any other utility. Board Staff is proposing reduction to these amounts. The Council is concerned that Hydro One’s costs are out of line with other distributors. The Council does not believe the evidence in this proceeding is sufficient to allow recovery of these costs, or deny recovery on some basis as proposed by Board Staff. The Council supports moving the issue to a separate

proceeding which would allow for a full examination of the costs and allow Hydro One to provide a further justification as to the level of costs and why Hydro One is such an outlier relative to other distributors.

XIII. COSTS

The Council requests that it be granted 100% of its reasonably incurred costs for its intervention in this proceeding.

All of which is respectfully submitted.