Ontario Energy Board

Commission de l'énergie de l'Ontario

EB-2013-0416/EB-2014-0247

IN THE MATTER OF AN APPLICATION BY

HYDRO ONE NETWORKS INC.

FOR APPROVAL OF DISTRIBUTION RATES FOR 2015 TO 2019

DECISION
March 12, 2015

This page was left intentionally blank.

EB-2013-0416/EB-2014-0247

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, and each year thereafter to December 31, 2019.

AND IN THE MATTER OF an application by Hydro One Networks Inc. for an order approving an exemption from sections 7.5.1 and 7.5.2. of the Distribution System Code.

BEFORE: Ken Quesnelle
Presiding Member

Marika Hare
Member

Emad Elsayed
Member

DECISION

March 12, 2015

This page was left intentionally blank.

TABLE OF CONTENTS

1.0 INTRODUCTION AND SUMMARY

This is a Decision of the Ontario Energy Board (OEB) in response to an application by Hydro One Networks Inc. (Hydro One) for permission to charge certain distribution rates to its customers.

Hydro One owns and operates the largest electricity transmission and distribution system in Ontario. The transmission system is made up of a high voltage network of transmission lines, steel towers and equipment. It conveys electricity long distances from electricity generation facilities to large power consumers, urban centres and to transformer stations. The distribution system consists of a lower voltage network of distribution lines, poles and equipment. It conveys electricity at lower voltages from the transformer stations to homes and businesses throughout the province.

Hydro One applies for transmission rates and distribution rates separately. This Decision deals with an application by Hydro One for the approval of distribution rates.

Hydro One's distribution system serves primarily the rural and remote areas of the province. Its 122,000 km distribution system serves about 1.3 million end-use customers and smaller electricity distributors.

The rates that the OEB has approved in this Decision are set based on the OEB's determination of the level of revenue that is required by Hydro One to cover the reasonably incurred costs of operating and maintaining the distribution system at a level of service that meets the needs of its customers.

A few years ago, the OEB reviewed its approach to setting distribution rates for regulated distribution companies in Ontario. The resulting policy was introduced in October of 2012 in a Report of the Board titled *Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach* (RRFE). The RRFE policy provides options in the way a distributor can structure its rate-setting application. The array of options allows flexibility so that a distributor can choose a rate-setting structure that best matches its needs in terms of the amount and variability of its capital investment needs.

The RRFE policy, as the report title states, is a performance based approach to regulation that supports the cost-effective planning and operation of the electricity

distribution network. The OEB intends that the policy provide an appropriate alignment between a sustainable, financially viable electricity sector and the expectations of customers for reliable service at a reasonable price.

There are three main areas in which the OEB describes its expectations and desired outcomes in the policy report: rate-setting, planning, and measuring performance. The OEB has evaluated Hydro One's application against the policy objectives pertaining to these areas and the RRFE policy in general.

The Custom Incentive Rate-setting option (Custom IR) is one of the rate setting options contained in the RRFE policy. It is at minimum, a five-year plan and is described as being suitable for distributors with large or highly variable capital investment requirements. It was under this option that Hydro One applied for rates covering a five year period.

Hydro One asked the OEB to approve increases to distribution rates for each of the years 2015 through to 2019. The total annual increases requested represent growth in distribution revenues of 29%, from $1.25 billion in 2014 to $1.61 billion in 2019[1]. The OEB finds Hydro One's evidence in support of its proposed revenue requirement to be generally adequate. However, the OEB notes that, despite having applied under the Custom IR framework, Hydro One characterized its application as a "Custom Cost of Service" application. The company indicated that cost savings from productivity improvements were embedded in cost forecasts, and that the company would bear the risk of failing to achieve these savings. The OEB does not consider Hydro One's "Custom Cost of Service" application to be sufficiently aligned with the objectives of the RRFE policy to approve the application as presented. Also, the OEB does not consider it acceptable to postpone the potential commencement of an appropriately-structured **incentive based** rate setting framework until 2020 following the five year period proposed by Hydro One.

The OEB accordingly denies Hydro One's request for five year rate setting. However, the OEB will approve rates for 2015, 2016, and 2017 using a cost of service methodology, based on the evidence filed and tested in the hearing. This results in an increase in distribution revenues of about 19% from 2014 to 2017, compared to Hydro One's request of a 29% increase over a five year period as cited above.

[1] Exhibit J3.3, September 12, 2014

The OEB has determined that it is appropriate to approve cost-based rates for a three year period for the following reasons:

- The OEB is persuaded that Hydro One's work plans in the short term are vital to maintain system reliability and that Hydro One requires more revenues than are currently being collected in order to perform this work. Complete denial of Hydro One's application is therefore not a reasonable option in this case.

- The OEB finds that sufficient evidence was provided to be able to set just and reasonable rates for the shorter period of 3 years.

- The OEB expects Hydro One to undertake a review of its approach to performance management and to reflect the objectives encompassed in the RRFE policy in its next application. The OEB considers two years – the anticipated time period before Hydro One applies for 2018 rates – to be an appropriate amount of time for Hydro One to undertake the types of initiatives that are necessary in advance of its next rates application.

The OEB has determined that Hydro One's approach lacks the RRFE features designed to achieve a central policy objective of measuring performance and providing incentives for continuous improvement. Hydro One is directed in this Decision to initiate a number of activities and report the results as part of its next rate application. A discussion of specific shortcomings of Hydro One's application follows in the body of this Decision.

The OEB has determined that Hydro One's capital spending plan is justified over the three year period approved in this Decision. Hydro One's proposed spending on compensation, vegetation management, and conservation and demand management has not been fully accepted, for the reasons provided in the body of this Decision. The OEB still expects Hydro One to execute and achieve its proposed work plans with the lesser amount of spending that has been accepted. This imposes a need for Hydro One to find efficiency gains for each of 2015, 2016 and 2017. The rates the OEB will set reflect the spending levels approved in this Decision.

This Decision determines the total amount of revenue Hydro One will be permitted to recover from its customers; and also the way the proportion of revenue to be recovered

from each customer class (group of customers with common characteristics) is to be calculated. In response to this Decision, Hydro One will provide updated information that reflects the OEB's findings. The precise impact on customers' bills will be known after that information is received.

Hydro One has a customer class known as Seasonal. These customers receive electrical service at dwellings that are not their primary residence. Hydro One's application contained a proposal to make changes with respect to Seasonal Rates. Hydro One withdrew its proposal in light of the submissions received from the parties in this proceeding. The OEB has determined that the Seasonal customer classification is no longer justified and directs Hydro One to prepare a plan by August 4, 2015 for the elimination of the seasonal rate class commencing January 1, 2016.

The OEB has also approved the recovery of past investments in Smart Meters.

Hydro One applied for an exemption from a section of the Distribution System Code (DSC) as part of this rates application. The section of the DSC deals with a distributor's obligation to attempt to contact customers every time a service appointment will be missed. Hydro One submitted that it cannot meet the DSC requirement. The OEB established a separate file number for the exemption request because it affects Hydro One's licence, not its rates, but the OEB heard the evidence and arguments on the matter at the same time as matters dealing with Hydro One's rate application.

The OEB has denied Hydro One's request for an exemption. The OEB's analysis of the issues and reasons for its determination are included in this Decision.

2.0 ORGANIZATION OF THE DECISION

As summarized above, the OEB has determined that it will approve rates for 2015, 2016, and 2017, based on the evidence filed, using a cost of service methodology as opposed to the five year “Custom Cost of Service” format that Hydro One requested.

The OEB has organized this Decision into chapters, reflecting the issues that the OEB has considered in making its findings. Each chapter covers the OEB’s reasons for approving or denying certain aspects of the application in the form requested and its determinations on what level of spending is allowed in the calculation of Hydro One’s rates using a cost of service methodology.

The initial chapter provides a description of the RRFE policy and why Hydro One has not convinced the OEB that the objectives of the policy are likely to be achieved under Hydro One’s Custom Cost of Service plan.

Subsequent chapters deal with the proposed work plans of Hydro One in terms of operations and maintenance spending as well as its capital spending and how it developed its capital spending plan.

Matters dealing with the development of the rates themselves are covered in chapters dealing with revenue requirement (which incorporates the results of the budgets for capital and operations and maintenance, cost of capital, depreciation, etc.), load forecast, cost allocation and rate design.

Hydro One has applied to have previously spent money approved for inclusion in rates as well. This money is tracked in accounts known as deferral and variance accounts (DVAs) that were previously approved by the OEB for tracking purposes. They include an account for spending on Smart Meters. These issues are dealt with in a separate chapter.

The OEB’s determination on the DSC exemption request is also included in a stand-alone chapter.

An account of the proceeding containing a list of the participants and witnesses is attached as Appendix 1. This appendix also contains a list of the acronyms or short

forms used in this Decision to identify intervenors. The transcription record of the decision on a motion by the City of Hamilton is attached as Appendix 2.

3.0 ALIGNMENT WITH THE RENEWED REGULATORY FRAMEWORK FOR ELECTRICITY

The Renewed Regulatory Framework for Electricity is a comprehensive, performance-based approach to regulation that focuses on the achievement of outcomes that ensure Ontario's electricity system provides value for money for customers. The OEB's RRFE Report (*Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach*, issued October 18, 2012) provides three rate-setting options under which a distributor may apply for rates to be set, depending on its capital requirements.

The Custom Incentive Rate-setting option (Custom IR) is described by the OEB as suitable for distributors with large or highly variable capital requirements. Hydro One applied for rates under this option, and asked the OEB to set rates for each of five years (2015 – 2019) based on its cost forecasts for those years. The company indicated that cost savings from productivity improvements were embedded in the cost forecasts, and that the company would bear the risk of failing to achieve these savings.

At page 13 of the RRFE Report, the OEB provides a table of the elements of each rate-setting method. Parties in the hearing criticized Hydro One's application as being non-compliant or inadequate with respect to some of these elements. The criticisms included:

- The form of the application: Custom Cost of Service rather than Custom IR
- Lack of a productivity factor
- Lack of a stretch factor
- Weak benchmarking evidence
- Lack of appropriate sharing of benefits between the utility and its customers (e.g. through an earnings sharing mechanism)
- Proposed annual adjustments, unforeseen events and off-ramps that differ from OEB policy

- Overall lack of consistency and comparability with incentive rate-setting particularly with regard to the specification and use of a custom index approach to rate-setting that includes explicit, externally imposed improvement incentives.

In its May 30, 2014 evidence update, Hydro One provided eight outcomes by which to measure its five year plan. The company agreed to report annually on these outcomes, including the results achieved and actual amounts spent on the programs. Many parties submitted that additional reporting, for example, on actual capital spending and the results of the smart grid program, was necessary.

Parties submitted that the inadequacies of the application should be addressed by the OEB through either denial of the five year application (i.e. set rates for only one or two years) or substantive adjustments to the five year plan such as using 2015 as a base year and setting rates for 2016 – 2019 through an index.

Findings

The OEB has concluded, for the reasons set out below, that Hydro One's application is insufficient as a Custom IR application under RRFE and has determined that it will deny approval of the proposed five-year plan. Instead the OEB will approve rates for a three-year period based on the evidence provided. This change from what was applied for by Hydro One is due to a number of shortcomings with Hydro One's proposed approach. The OEB is directing Hydro One to address those shortcomings, set out below, over the next three years in preparation for the next rates application.

3.1 Inconsistency with outcome-based regulation

Hydro One chose to interpret the OEB's Custom IR option, referred to in the RRFE Report as "custom index", to include "custom cost of service". The OEB does not accept this interpretation. All three rate-setting methods are described in the Report as incentive rate-setting, not cost of service.

Cost of service rate-setting has an important role in performance-based regulation regimes to periodically examine in detail the costs and activities underpinning rates. However, the OEB continues to believe that multi-year incentive rate-setting, with its emphasis on results, is the most effective way to incent behaviour similar to that seen in commercially-oriented, consumer market-driven companies. Incentive rate-setting differs from cost of service rate-setting in that it relies less on a utility's internal cost, output, and service quality to establish rates, and more on benchmarks of cost, output, and service quality that are external to the utility revealing superior performance and encouraging best practice. The decoupling of rates from the utility's own costs simulates a competitive market environment and is more compatible with an outcomes-based approach to regulation.

The OEB finds that Hydro One's proposed plan is deficient in this regard, as it includes limited prospects for continuous improvement, lacks any externally imposed improvement incentives, includes limited cost and productivity benchmarking support, and fails to demonstrate value to customers commensurate with the forecasted spending.

3.2 Lack of externally imposed incentives

The OEB expects Custom IR rate setting to include expectations for benchmark productivity and efficiency gains that are external to the company. The OEB does not equate Hydro One's embedded annual savings with productivity and efficiency incentives. Incentive-based or performance-based rates are set to provide companies with strong incentives to continuously seek efficiencies in their businesses.

The OEB does not believe that Hydro One's plan contains adequate efficiency incentives to drive year-over-year continuous improvement in the company. Furthermore, the plan lacks measurement of increased efficiency year-over-year in a form illustrating trends in a transparent fashion.

It is not sufficient to embed savings in cost forecasts. As already noted, the OEB's Custom IR is an incentive rate-setting approach designed to drive efficiencies. Benefits

from explicit, objectively determined productivity and efficiency adjustments such as stretch factors include mimicking competitive market conditions, sharing anticipated savings with ratepayers “up front”, and facilitating a more outcome-based approach to regulation.

As already noted, traditional cost of service review will continue to entail detailed input cost assessments. However, Custom IR proceedings are intended to be framed more like performance inquiries resulting in multi-year outcome commitments and measures that facilitate year-over-year performance assessment. The productivity and efficiency elements allow the OEB to move away from detailed input cost assessment and focus more on utility performance. These factors provide utilities with strong incentives to continually seek efficiencies and share expected savings with ratepayers “up front” avoiding “after the fact” regulatory scrutiny.

3.3 Weak benchmarking evidence

The RRFE policy articulates the importance the OEB places on benchmarking. Benchmarking evidence, whether it compares a utility’s performance to itself year-over-year, or to other utilities, is a critical input to the OEB’s assessment of utility performance.

Benchmarking, when used in combination with specific cost drivers and other sources of utility performance information, allows for an overall assessment of a utility’s cost and outcome performance.

A majority of parties were critical of the lack of benchmarking in Hydro One’s plan. Hydro One described eight benchmarking or similar studies it had undertaken. The OEB agrees with the submissions of OEB staff and the majority of the intervenors that the studies provided in this proceeding by Hydro One, lack:

1) a top-down perspective of what the appropriate level of costs should be; and

2) measures of Hydro One’s cost performance against other comparable utilities.

Parties also pointed out that no total factor productivity study, capital cost benchmarking study or an overall OM&A benchmarking study, were submitted.

Accordingly, the OEB does not find this evidence sufficient to provide a complete assessment of Hydro One's cost and outcome performance. The OEB disagrees with Hydro One's assertion that external benchmarking will not assist the OEB in determining whether costs at Hydro One are reasonable. As stated earlier, benchmarking information is used in combination with specific cost drivers and other sources of utility performance information. Benchmarking evidence is expected to include an explanation of any significant divergence from the optimal benchmark.

While the OEB considers Hydro One's benchmarking efforts for this proceeding to be inadequate, the weakness of the benchmarking evidence does not completely impede the OEB's ability to assess the reasonableness of the cost forecasts in this case. As described later in this Decision, the OEB will disallow some of the requested costs in certain areas, and direct Hydro One to address a number of shortcomings in its plan, including specific benchmarking evidence the OEB expects to be filed in Hydro One's next rates application.

The OEB acknowledges that Hydro One expressed concern over the OEB's approach to estimating total factor productivity and benchmarking of distributors' total costs as it applies to Hydro One. Despite Hydro One's perception of shortcomings of the approach, the OEB's studies do provide important information regarding Hydro One's performance. For example, according to the 2013 Benchmarking Update[2], Hydro One's average cost performance has improved by 10.4% over the 2012 benchmarking study.

In addition, as OEB staff pointed out in its submission, Hydro One's response to staff IR #60 showed that "…while Hydro One's productivity continues to be negative, it appears it may become less so." In other words, while Hydro One's productivity trend is negative, the evidence indicates that the trend may become less negative and may continue to improve over the next few years.

[2] Empirical Research in Support of Incentive Rate-Setting: 2013 Benchmarking Update prepared for the OEB by Pacific Economics Group Research, LCC, issued July 2014, Table 3.

The OEB sees value in Hydro One measuring its own total factor productivity over time to be able to demonstrate improvement in productivity to its customers and the OEB. The OEB requires Hydro One to conduct such a study. Given Hydro One's concerns, the OEB leaves it to Hydro One to determine its preferred total factor productivity study method. However, the period of the study should include years at least going back to 2002. The results of the study must be filed as part of Hydro One's next rates application.

3.4 Limited prospects for continuous improvement

The OEB is concerned that under Hydro One's proposed plan, lack of efficiency incentives lessens the probability of achieving continuous improvement.

Hydro One's forecasted annual savings built into its forecasted costs are summarized in the evidence[3]. Several parties noted, and Hydro One acknowledged, that most of the savings come from investments made in 2010 through to 2014. In its submission, OEB staff calculated Hydro One's new savings each year for 2015, 2016, 2017, 2018 and 2019 at $27.7 million, $8.1 million, $3.8 million, $1.0 million, and $0.2 million, respectively. In short, the savings are declining over time.

While Hydro One characterises its forecasted annual savings as ambitious, the OEB is concerned that the declining trend and relatively small savings do not show Hydro One to be a company with a strong orientation towards continuous improvement. Furthermore, Hydro One's proposed plan does not include any measure of continuous improvement. In response to questions from parties on how any savings beyond those forecasted will be measured and treated, Hydro One indicated that any such savings would be re-invested into the company's work plan. Hydro One explained that its customers would benefit from this re-investment though the additional work that Hydro One would be able to carry out.

Hydro One has stated that it is in the fourth quartile of North American utility performance with respect to system reliability and that it has no plan to improve on that

[3] Exhibit A Tab 19 Schedule 1, page 4, Table 2

score. It submits that to do so would not be cost effective and its customers would not want to pay the cost associated with the improvements. The OEB considers Hydro One's stance on its performance to be misplaced. Rather than argue that it would be too expensive to move up the ladder in comparison to those that are in the first, second and third quartile, Hydro One should be finding cost effective ways to improve its performance and provide evidence intended to convince the OEB that it has identified more appropriate benchmarks to which it can and will compare itself for continuous improvement tracking purposes.

The OEB expects distributors to embrace the principles of continuous improvement and to develop plans which provide benefits to customers. If the benefits are considered to be the ability to re-invest in additional work then the product of that additional work should be measurable desired outcomes.

3.5 Value to customers

The OEB agrees with the Canadian Manufacturers and Exporters' (CME's) characterization of RRFE as a shift in focus for rate regulation away from input cost assessment to utility performance, underscored by an understanding of value for customers.

It is the OEB's view that Hydro One's customer engagement in relation to its application appears to have been generally good, with the exception of the consultation regarding seasonal rates (which was criticized by a number of parties). Otherwise, the OEB accepts that Hydro One made a good attempt to understand what its customers want and link that to the priorities in its proposed plan.

Hydro One's responsiveness to feedback is evident in the way its proposed plan evolved over the course of the pre-hearing and hearing processes. The resultant set of eight outcome measures are a reasonable reflection of the areas where Hydro One is proposing to increase capital or operating expenditures over the next few years. Hydro One proposed targets for each measure. While varying views and some concerns were expressed by parties on certain details associated with Hydro One's proposed

measures, the OEB supports Hydro One's overall approach to customer engagement. However, the OEB notes that some of Hydro One's chosen measures may not be effective measures of value to customers. In Hydro One's proposed plan, spending levels are clearly measured, but from a customer's standpoint, what will be gained from that spending is not always clear.

A number of Hydro One's measures are activity-based such as the number of substations refurbished, rather than being outcome-based whereby the number of outages avoided or length of outages reductions as a result of the substation refurbishment would be measured.

Furthermore, in some cases the trends in targets for the proposed measures do not show year-over-year improvement. Based on the evidence provided, it is unclear whether Hydro One's customers would understand the value proposition associated with Hydro One's plan.

The Association of Major Power Consumers (AMPCO) proposed revisions to a number of Hydro One's outcome measures for the Board's consideration:

- Vegetation management and pole replacement should be based on a cost per unit metric.

- The proposed measure "number of PCB oil replacements" does not equate with the RRFE expectations of continuous improvement and cost effectiveness. "Cost per pole-top transformer with PCB oil replaced" would be a more appropriate measure.

- The substation refurbishments metric could be revised to reflect unit costs instead of number of substations refurbished, with a cost per transformer refurbished or cost per transformer replaced as a more appropriate metric.

As previously noted, it is clear that the distribution system is in need of investment, and changes to system performance may not be immediately visible. Rather, system performance may erode without the investment. However, the OEB agrees with

AMPCO's suggestion that in the absence of an outcome measure to demonstrate performance improvement value to customers, Hydro One could have brought forward unit cost metrics to demonstrate cost performance improvements (e.g., reduced cost per transformer replaced). This is another way to demonstrate value for customers.

4.0 OPERATIONS, MAINTENANCE AND ADMINISTRATION COSTS

Operations, maintenance and administration (OM&A) costs are the largest component of Hydro One's revenue requirement, in the order of $600 million per year during the plan term. Included in OM&A costs are employee compensation, corporate costs, customer services and operations costs. These operations costs capture day-to-day maintenance of the system, including vegetation management. Also included in OM&A are costs related to work requested by customers ("demand" work) such as restoring service interruptions, repairing failed equipment or responding to customer requests.

Arriving at an appropriate OM&A budget is critical in ensuring that Hydro One has sufficient funds to operate a safe and reliable system while at the same time considering the customer bill impacts so that any increase is fully justified and reasonable.

In reviewing the OM&A budget, the OEB also considers Hydro One's efforts in achieving efficiency gains (i.e. doing more work with fewer resources), implementing innovation and demonstrating continuous improvement in performance. One general criticism by parties to this proceeding was that Hydro One's evidence did not demonstrate operating efficiencies through benchmarking, cost control or continuous improvement. The importance of these elements has been addressed previously in this Decision within the discussion of conformance with the RRFE. In this section, the OEB will focus on the actual budget proposed in order to determine the OM&A amount to be included in the revenue requirement calculation.

Over the proposed plan term Hydro One's OM&A costs are relatively constant. The cost per customer declines slightly but the cost per kilometre of line increases.[4] Parties to the hearing generally accepted the proposed OM&A budget as being reasonably controlled over the life of the plan insofar as the proposed budget represents an increase less than would result if the last OEB-approved budget were adjusted by the rate of inflation.

[4] Cost per customer is down 1.3% from 2014 to 2019, while cost per km rises by 3.2%. Exhibit I/Tab 3.01/Staff 38

Despite general agreement by parties that the overall budget was reasonable, parties criticized employee compensation (including pensions and benefits), vegetation management costs and the conservation and demand management budget. Each of these areas is addressed below.

4.1 Compensation

In 2014, Hydro One's total compensation for all of its 5,400 regular employees[5] was approximately $617 million[6]. Compensation includes employee base salary, short and long term incentives, pensions and benefits. The total compensation for all employees, including temporary and casual, is $807 million in 2014. Along with the total number of employees Hydro One requires to complete its work programs, the proportional mix of those employees (regular, temporary and casual) directly affects the compensation cost total.

Many parties expressed concern with the richness of Hydro One's employees' compensation. The OEB has ruled on this issue in previous Hydro One rate applications. The last Hydro One distribution cost of service proceeding for 2010/2011 rates reviewed this issue and the OEB's findings included a reduction in the OM&A envelope to account for this high compensation cost relative to the industry. In Hydro One's transmission case (EB-2010-0002) the OEB also expressed concerns about compensation levels and the productivity being achieved.

The Mercer Study, commissioned by Hydro One and filed in this proceeding showed that compensation is about ten per cent higher than industry comparators at the market median.[7]

In this proceeding, many parties acknowledged that the evidence demonstrated that Hydro One is moving towards the market median for compensation. Hydro One has done so through a number of cost-cutting measures such as adjusting the staff mix to increase the use of temporary and casual staff, a strategic approach to contract

[5] This includes both Hydro One's Transmission and Distribution businesses.
[6] Exhibit C1-3-2 Attachment 1, p. 3 and Attachment 2
[7] Exhibit C1-3-2, Attachment 1: Mercer Compensation Cost Benchmarking Study, December 9, 2013

negotiations, and other hiring practices. However, parties argued that the ten per cent premium in compensation costs should not be recovered in full from ratepayers. The Mercer market median was suggested as a suitable level of recovery. Hydro One indicated that bringing the compensation to the market median level would result in a reduction of about $15.4 million per year in OM&A costs.[8]

This argument about reducing compensation was made with awareness of the legal context in which Hydro One operates, which requires the company to negotiate and abide by collective agreements with its unionized workers, who make up the majority (about 90%) of Hydro One's staff. Only the Power Workers' Union argued that Hydro One's compensation is reasonable and that Hydro One has behaved prudently and achieved reasonable results through collective bargaining.

Findings

The OEB recognises Hydro One's challenge in managing its compensation levels in a highly unionized environment. However, the OEB must determine a reasonable compensation amount to be included in the revenue requirement and thus borne by ratepayers.

A consideration of the appropriateness of compensation levels should be influenced by what a company can demonstrate is necessary to attract and retain employees with the skills and competencies it requires to accomplish its required outcomes. Hydro One's recent positive movement in getting closer to the market median has, in part, been a result of its compensation packages for new hires.

There has been a considerable focus on the market median of compensation levels over several years now. While Hydro One may focus on the market median as a benchmark, and target parity with it as a goal, it does not negate the OEB's need for evidence that illustrates the level of compensation required to allow Hydro One to attract and retain employees with the skills and competencies it requires.

[8] Undertaking J3.12

As is the case with any benchmark comparison, the need for cogent evidence to justify a level of spending or level of service quality is commensurate with its deviation from the level demonstrated by similar distributors. For instance, if a company spends more for a particular service or activity than most other comparable companies, it must provide more evidence for the level of proposed spending than if its level of spending was less than comparable companies. The OEB uses benchmarking as a tool to focus and prioritize its attention on certain costs. Benchmarking increases the efficiency of regulatory oversight. It does not replace the need for substantiating evidence in support of spending levels.

Hydro One did not provide sufficient evidence in support of its proposed compensation spending. The company did not demonstrate that the market requires the level of compensation proposed in order to attract and retain the necessary employees. In the absence of such evidence the OEB will use the market median as a reference point for the percentage of compensation costs that will be included in the rates paid by Hydro One's customers.

As previously stated, in arriving at an appropriate OM&A budget it is critical to ensure that Hydro One has sufficient funds to operate a safe and reliable system. The OEB must balance the ability of Hydro One to perform the work that is necessary to maintain the system and the fairness to its customers in paying for a level of compensation that has not been satisfactorily substantiated. In the absence of evidence indicating that higher levels of compensation are justified, the market median compensation level provides an indication that Hydro One customers are being asked to pay too much for the provision of the service they receive. As noted above, Hydro One indicated that if its compensation level were set at the market median level it would result in a reduction of about $15.4 million per year in OM&A costs.

While the OEB recognizes the progress that Hydro One has made over the last few years in getting closer to the market median, the OEB does not find that it is fair that ratepayers pay for a 10% premium over the market median. The OEB, however, will not disallow the entire 10% premium. Rather, the OEB will require efficiency from Hydro One by disallowing half of that amount from the revenue requirement, or $7.7 million per year, each year for 2015, 2016 and 2017. The OEB still expects Hydro One

to accomplish the work programs as outlined. In addition, the OEB directs Hydro One, in its next rates application, to file a compensation study similar to the one filed in this proceeding so that the OEB can continue to benchmark Hydro One's compensation against that paid by comparable companies.

A few parties raised concerns regarding Hydro One's pension and benefits plan, including the plan's long-term sustainability, the level of contribution by employees, and the possible need to review the accounting for other post-employment benefits. Hydro One has reduced the employer pension contribution level such that the employer/employee ratio for 2015 is planned to be 72/28. Hydro One has indicated that it plans to move to a 65/35 ratio by 2019.[9] This progress must continue, and the OEB encourages Hydro One to continue to move toward a 50/50 ratio, the generally recognized norm in public sector defined benefit pension plans.

Submissions were made concerning the need for a generic review of pension and other post-employment benefits. The OEB agrees that this issue is more appropriately dealt with on a generic basis. A generic proceeding could enhance understanding of the different rate making options, establish policy and decide on how best to apply that policy to Hydro One and other Board-regulated entities. Any changes to pensions and other post-employment benefits for Hydro One, if required, could be addressed by the OEB in Hydro One's next cost of service proceeding, having been informed by the outcomes of a generic proceeding. The OEB will not adjust the pension costs or pension accounting methodology at this time, but expects that a generic review may result in some changes applicable to Hydro One's next rates application. No specific disallowance with respect to pension or other pension and benefits costs is made in this Decision.

4.2 Vegetation Management

Most parties objected to Hydro One's proposed increased vegetation management budget (which includes cost for tree and brush clearing). The OEB agrees with the concerns expressed and is concerned that overall, Hydro One's vegetation

[9] Exhibit I/Tab4.03/Schedule 1/Staff 68

management budget shows no achieved efficiencies or productivity. The evidence shows an increase in unit costs for vegetation management activities related to tree line clearing. This is a significant component of OM&A, accounting for about $100 million per year. On the other hand, brush control unit costs show improvement in 2015 over 2013 actuals, and are fairly steady during the plan period.

The OEB does not accept Hydro One's explanation that increased tree densities and work complexities contribute to unit cost increases as Hydro One moves towards an 8-year clearing cycle. The evidence in the last cost of service proceeding (EB-2009-0096) indicated that Hydro One was already on an 8 year cycle, and was seeking additional funds to move to a 7 year cycle. In this proceeding, Hydro One indicated it was on a 9½ year cycle, and that it would take until 2023 to achieve the goal of being on a sustainable 8 year vegetation management cycle.

The OEB notes that the 2011-2012 CN Utility Benchmarking analysis[10] showed that Hydro One had the highest vegetation management cost per customer relative to its peers. This benchmarking comparison emphasizes the need for Hydro One to provide detailed and thorough evidence substantiating its spending requirements and how it intends to continuously improve in this activity. Hydro One's solution to a reduced vegetation management budget appears to be to scale back on this necessary program.[11] While the OEB acknowledges Hydro One's submissions on dealing with remoteness and difficult terrain, the OEB still expects Hydro One to show continuous improvement in these areas. This may mean a change in the labour mix for this work or further innovation in undertaking the program. It is the OEB's view that Hydro One needs to manage this program more cost effectively.

The OEB finds that a reduction of $39 million to the total vegetation management costs over the 2015 to 2017 period is appropriate. This was arrived at by taking the average unit cost for line clearing from 2011 to 2013 ($7,588 per km) and applying it to the volume of work projected to be undertaken over the three-year period.

[10] Exhibit J3.10 p. 33
[11] Hydro One Reply Argument, October 27, 2014, page 52

The OEB also directs Hydro One to present in its next rates application a comprehensive trend analysis of its vegetation management program showing year-over-year comparisons in unit costs. Further, the OEB encourages Hydro One to explore best practices in vegetation management with other distributors and transmitters, similar to the CN Utility Study filed with the OEB in the EB-2009-0096 proceeding, and file any resulting study in its next rates application.

4.3 Conservation and Demand Management (CDM)

Hydro One has requested approval to recover approximately $3 million annually for work conducted by its utility staff to support CDM programs. This budget includes costs for labour, research and development, collaboration within the sector and maintaining a base level of CDM capability required to participate in industry activities, including testing of new technologies and delivery of pilot programs.

The OEB agrees with the submissions of the Sustainable Infrastructure Alliance (SIA) that the roles of distributors with respect to CDM have changed since Hydro One's last rates decision, and that CDM program development costs should not continue to be included in base distribution rates. The Independent Electricity System Operator (IESO), which merged with the Ontario Power Authority (OPA) at the beginning of 2015, is charged with developing CDM programs for Ontario, and utilities have been implementing the former OPA's programs with funding made available through the OPA. Hydro One should not be including a research and development budget to develop and test CDM programs in parallel with the efforts of the organization chiefly responsible for them.

While there are no filing requirements for CDM activities specific to Custom IR, the OEB's *Filing Requirements for Electricity Distribution Rate Applications* ("Filing Requirements") in Chapter 2 state the following:

> CDM activity is funded either through OPA-Contracted Province-Wide CDM Programs, or through Board-approved CDM programs. Both of these approaches fund the programs through the global

> adjustment mechanism, and therefore costs directly attributable to these CDM programs (e.g., staff labour dedicated to such programs) must not be included in distribution rates.[12]

The OEB finds that this policy applies in this case. The OEB will therefore not approve Hydro One's request for approval of approximately $1 million of annual rate funding to support CDM research and development.

The Minister of Energy issued separate Directives dated March 26, 2014 to the OEB and the OPA related to electricity conservation (the Conservation Directives). Both Directives state that distributors will be required to make CDM programs available to customers in their licenced service areas between January 1, 2015 and December 31, 2020. The Conservation Directive to the OEB requires the OEB to amend the licence of each licensed electricity distributor, among other things, to:

> Add a condition that specifies that the Distributor shall meet its CDM Requirement by:
> a) Making Province-Wide Distributor CDM Programs, **funded by the OPA**, available to customers in its licensed service area;
> b) Making Local Distributor CDM Programs, **funded by the OPA**, available to customers in its licensed service area; or,
> c) A combination of (a) and (b).[13] [Emphasis added]

The Conservation Directive to the OPA also states that:

> The OPA Conservation Fund provides financial support to new and innovative electricity conservation initiatives designed to enable Ontario's residents, businesses and institutions to cost-effectively reduce their demand for electricity.
>
> The OPA shall continue to provide, through its Conservation Fund, support and funding for new and innovative electricity conservation initiatives, including small scale distribution storage technologies, as a means to assist Distributors and others in their conservation efforts. [14]

It is clear from the Conservation Directives to the OEB and the OPA that funding for CDM program research and development between 2015 and 2020 will be provided by the OPA. This funding comes from the global adjustment mechanism and not from

[12] Ontario Energy Board, Filing Requirements for Electricity Distribution Rate Applications – 2014 Edition for 2015 Rates Applications, Chapter 2, Cost of Service, Section 2.7.6, Conservation and Demand Management.
[13] Directive from the Minister of Energy to the OEB, March 31, 2014, Page 1
[14] Directive from the Minister of Energy to the OPA, March 31, 2014, 2015-2020 Conservation First Framework, Section 8 – Support and Funding for Research and Innovation, Page 11

distribution rates. Hydro One should be receiving the necessary funding it requires to deliver CDM programs and meet its CDM Requirement from the OPA.

However, Hydro One has been one of the province's leaders in CDM, including co-ordination with other distributors, participating in energy sector education and collaboration. For example, Hydro One has been an active participant with the OPA in CDM program review, with the Ministry of Energy and in OEB consultations with respect to CDM. The OEB sees the need for this leadership role to continue, and therefore sees merit in including the requested labour costs associated with CDM in the OM&A budget.

In addition, the OEB notes that should Hydro One need additional funding to support CDM activities incremental to its CDM requirement which are not made available through the province-wide distributor CDM programs between 2015 and 2020, it may make a separate application to the OEB for approval of funding associated with a specific CDM program which is currently not offered by the OPA and for which Hydro One would seek OEB approval to pursue.

Overall Impact with Respect to OM&A

As a result of the findings, the approved OM&A budget is summarized in the table below.

Table 1
Operations, Maintenance and Administration Costs
Summary of Findings
2015 to 2017

	2015 ($ million)	**2016 ($ million)**	**2017 ($ million)**
Requested OM&A	564.3	610.2	614.0
Less, compensation reduction	7.7	7.7	7.7
Less, vegetation management reduction	13.0	13.0	13.0
Less CDM reduction	1.0	1.0	1.0
OEB approved OM&A	542.6	588.5	592.3
Percentage Reduction as a result of this Decision	4.0%	3.7%	3.7%

5.0 DEPRECIATION AND AMORTIZATION

Hydro One proposed depreciation and amortization expenses for each of the 5 test years as shown below:

Table 2
Depreciation and Amortization Expenses[15]
2015 to 2019

Year	Depreciation and Amortization
2015	$355.4 million
2016	$374.9 million
2017	$390.2 million
2018	$402.9 million
2019	$413.6 million

The OEB notes that Hydro One updates its depreciation methodology whenever it files a cost of service rate application, as it did in this application with an updated Foster and Associates study.[16] Depreciation expenses were not challenged in the proceeding by OEB staff or intervenors.

Findings

The Board approves the depreciation expenses as filed for rate setting purposes from 2015 to 2017 and expects Hydro One to file an updated depreciation study with its next rates application.

[15] Exhibit C1/Tab6/Schedule1
[16] Exhibit C1/Tab6/Schedule1/Attachment 1

6.0 LEAP FUNDING

In its application, Hydro One proposed that it would provide $1.2 million in funding to the Low-Income Energy Assistance Program (LEAP). In reply to an SIA interrogatory regarding this level of funding[17], Hydro One stated that "The $1.2 million was calculated based on the prescribed OEB formula of 0.12% of HONI's Service Revenue Requirement." In its submission, the SIA pointed out that the service revenue requirement for 2015 is forecast by Hydro One to be $1,414.9 million and that this amount, multiplied by 0.12% results in a LEAP amount of $1.7 million, not $1.2 million as stated in Hydro One's evidence.

The OEB acknowledges the SIA submission and directs Hydro One to increase its LEAP funding amount for 2015 to $1.7 million for 2015 with the expectation that Hydro One will proportionally increase its annual contribution (as related to its service revenue requirement) over the 2015-2017 period.

[17] SIA Interrogatory Exhibit 3.1 - SIA 22

7.0 DISTRIBUTION SYSTEM PLAN, RATE BASE & CAPITAL EXPENDITURES

7.1 Distribution System Plan

The RRFE Report emphasizes the importance of planning as the foundation for rate-setting, and the filing requirements for distribution system plans (DSPs) are provided in Chapter 5 of the OEB's Filing Requirements. In support of its proposed capital investment programs, Hydro One filed a significant amount of evidence and provided a summary table which cross-referenced its evidence with the items required by the OEB to be included in a DSP[18].

Parties acknowledged Hydro One's efforts to continuously improve its asset management process and recognized that the new tools that Hydro One introduced would help it get more accurate and current information on its assets. However, some parties felt that Hydro One must still make further improvements to meet the intent of the Filing Requirements. The areas identified as being deficient included the following:

- The presentation of the various components of the DSP in different parts of Hydro One's application does not meet the intent of the OEB's requirement (Chapter 5) of having a "consolidated" plan.
- Investment levels do not yet appear to be properly aligned with the actual condition of the assets.
- The DSP does not clearly demonstrate the process by which Hydro One ensures the most effective use of capital and OM&A spending.
- Lack of third-party review or external benchmarking of Hydro One's processes and methodology to demonstrate that they are consistent with best practices.

OEB staff cited a number of examples in its submission where the linkage between the risk assessment results and the investment prioritization was not clear[19].

[18] Exhibit A, Tab 7, Schedule 1
[19] Board Staff submission, Section 4.2

Hydro One submitted that it has an industry-leading business planning process which is based on its business values and strategic objectives, and which considers a balance of its work programs and associated risks.

Findings

The OEB finds that Hydro One's evidence provides significant and useful details about its asset management and investment planning processes. The OEB also acknowledges that Hydro One continues to make improvements to these processes. However, the OEB agrees with the position of some parties that, while Hydro One's evidence contains the various key components of its processes, it does not provide a sufficiently consolidated plan as contemplated in Chapter 5 of the Filing Requirements.

As stated in Section 5.3 of the Filing Requirements, the information contained in the DSP "is to provide the OEB and stakeholders with an understanding of the distributor's asset management process, and direct links between the process and the expenditure decisions that comprise the distributor's capital investment plan". The OEB finds that such links are difficult to follow when the DSP components are not consolidated. Clear links would be crucial in demonstrating to the OEB that the resulting capital expenditure plans have been sufficiently optimized. In addition, this lack of consolidation of the DSP components could be confusing and may result in the use of inconsistent terminology for the different stages of the investment planning and optimization process.[20]

Hydro One's application provides an opportunity for the OEB to point out the advantage of having the consolidated DSP as a stand-alone document. The OEB directs Hydro One, in its next rates application, to provide a consolidated plan, preferably as a stand-alone document in a separate exhibit, with a direct and clear alignment of the various components, explicitly showing how the process steps lead to an optimized DSP and a corresponding capital investment program.

[20] Transcript Vol. 5, p. 21-23 and Board Staff submission, p. 42

The OEB also expects that Hydro One will consider the merits of having its DSP reviewed by an independent third party and, if done, to file that review in its next rates application. If not done, an explanation of that choice must be filed with the DSP.

7.2 Rate Base & Capital Expenditures

The following table shows Hydro One's forecast rate base for the 2015 to 2019 period. The rate base underlying each of the test years' revenue requirements includes a forecast of net fixed assets, calculated on a mid-year average basis, plus a working capital allowance.

Hydro One's proposed capital expenditures during the five-year plan term are also shown in the following table as well as the corresponding in-service capital additions.

Table 3
Rate Base, Capital Expenditures and
In-Service Capital Additions
2015 to 2019

	2015	2016	2017	2018	2019
Rate Base ($million)[21]	6,533	6,864	7,191	7,541	7,870
Capital Expenditures ($million)[22]	648.9	654.7	661.4	655.1	669.1
In-Service Capital Additions ($million)[23]	656.6	621.8	696.0	681.4	660.9

The evidence indicates that the biggest drivers of the rate increase sought by Hydro One are the increase in 2015 rate base, and the planned annual increases in certain capital programs. The increase in rate base is a result of capital additions made during

[21] Hydro One's Reply Submission, p. 7
[22] Hydro One's Reply Submission, p. 6
[23] Hydro One's Reply Submission, p. 6

the IRM period and proposed additions during the test years, including additions from regulatory assets, as well as the associated increase in return and depreciation amounts since last approved by the Board. The last approved rate base amount was $4,986.6 million for the 2011 test year. Hydro One witnesses testified that the need for increased capital spending going forward was largely attributable to under-spending in prior years, which has led to a large number of assets needing repair or replacement.

The proposed 2015 rate base increase was primarily due to the in-service additions made during the IRM period preceding this application. In general, parties accepted the proposed rate base for 2015 and subsequent years.

The largest component in the proposed capital spending is in the “sustaining” category, which includes investments required to ensure that existing distribution system facilities function as originally designed; an example of sustainment investment is the replacement of worn-out poles. Spending in this area shows the greatest growth, up 33.9% from 2014 to 2019, growing steadily from $286.4 million to $383.5 million. The “development” category, which includes investments required to serve new load and generation customers and meet the growing needs of existing customers remains relatively stable. The third category, known as “corporate common costs and other capital” investment, includes sustainment and enhancement of existing equipment and infrastructure, including information technology, transport and work equipment and service equipment, and facilities and real estate. Spending in this category is forecast to fall by 25.1% over the 5 year period.

Many parties submitted that the level of capital spending on sustaining capital programs over the five year period, particularly pole replacement and station refurbishment, was not adequately justified, and proposed that the OEB reduce the budgets for these activities. Hydro One submitted that these programs were essential given the age and condition of the assets in these categories, and that any reductions in the programs would exacerbate asset deterioration and increase unplanned spending on repairs made in reaction to an actual asset failure.

Several parties noted the lack of tangible unit cost reductions for capital work, and suggested a dollar per unit metric for reporting on pole replacement and station

refurbishment (and vegetation management, which is discussed in the OM&A section). In contrast, some parties submitted that Hydro One was continuing to underspend on its assets, given their age and condition.

As described in the DSP section, many parties submitted that the planning evidence was unclear and inadequate to provide the OEB with an understanding of Hydro One's planning and prioritization process. Although Hydro One has revised its planning process using new tools to assess risk and set priorities based on risk assessment, some parties found the risk scoring system difficult to understand and inconsistently applied to actual investment priorities and pacing.

In recognition of the perceived inadequacies of Hydro One's planning evidence, some parties proposed that in addition to reporting on the success of the capital program outcomes, the OEB should require Hydro One to report annually on asset condition. This would include establishment of a net cumulative asymmetrical variance account to track the impact on revenue requirement of any in-service capital additions shortfall compared to OEB approved amounts.

Findings

The OEB has determined that it will approve Hydro One's proposed rate base and corresponding capital expenditure plan for the 2015 to 2017 period as submitted. However, given the direction provided by the OEB in the previous section regarding the development of a more consolidated DSP, the OEB expects that the consolidated plan will provide a more cohesive and easily understood capital expenditure plan in Hydro One's next rates application.

In approving a 3-year capital plan, the OEB gave consideration to the following factors:

- Given some of the DSP shortcomings described earlier, a shorter approval period than 5 years is appropriate, consistent with the 3 year cost of service approach determined earlier in this Decision. The OEB expects that Hydro One will take the opportunity to make the necessary improvements to support a longer-term capital plan.

- While the evidence in this case supports the need for Hydro One to make investments in its assets in the short term, the OEB's level of confidence that capital spending has been optimized decreases in the longer term.
- The OEB accepts Hydro One's argument that significant reductions in the proposed 2015 to 2017 spending levels would likely create cost pressures in the longer term.
- Approval of capital spending for a shorter time period reduces the risk to ratepayers if in fact the capital program is unrealistic. Approval of a longer term plan at the time of Hydro One's next rates application will be contingent on the quality of the supporting evidence.

Since the OEB is approving a 3-year plan for Hydro One, the amounts proposed by Hydro One for 2015 to 2017 will form the basis of Hydro One's capital envelope and capital in-service additions. Given the shortened plan term, the OEB does not find it necessary for Hydro One to establish a variance account to track the impact of in-service additions shortfall on revenue requirement. At the time of Hydro One's next rates application, the OEB expects Hydro One to provide evidence of its capital in-service additions (actual vs. approved with explanations of any variances) on an annual basis, as required in the OEB Filing Requirements.

The OEB also directs Hydro One to conduct an external benchmarking study on the unit cost of its pole replacement and station refurbishment programs against other utilities as well as carry out an internal trend analysis to show the variability of these unit costs over time (year over year). Hydro One will report on the results of this work with the corresponding analysis as part of its next rates application.

The benchmarking and trend analysis of unit costs for these two programs is required because the company plans significant spending in these areas. However, as noted in the section of this Decision that discussed the RRFE, Hydro One should prepare supporting productivity evidence for its next rates filing for any areas of its business where recovery of significant planned spending is sought.

7.3 Working Capital

Hydro One proposed, as part of its 5 year rate plan, to adjust working capital annually. As only a 3 year plan is approved in this Decision, the Board will not require an adjustment to working capital in years 2 and 3. This approach is in keeping with the past practice in multiyear cost of service periods.

8.0 COST OF CAPITAL

Hydro One proposed an annual cost of capital adjustment (using the OEB's updated cost of capital parameters and an update of Hydro One's long term debt) before each new rate year, as per its past practice in implementing its multi-year rate setting decisions.

The OEB agrees that these updates should continue in this case for the 3 year period of this rate approval. No change to the debt/equity structure was proposed.

9.0 REVENUE REQUIREMENT AND RATE SMOOTHING

Hydro One applied for the OEB's approval of a revenue requirement for each of the five years of the rate plan. OEB staff noted that the company's revenue requirement grew by 19% between 2011 and 2015 (largely due to capital additions) and would grow by 17.8% from 2015 – 2019. Due to the large increase in revenue requirement in 2015, Hydro One proposed rate smoothing by way of rate riders over the five year period of the plan, resulting in an annual average distribution revenue increase of 6.3%. If the Hydro One application were accepted as filed, typical UR and R1 customers would experience a total bill impact of less than 2% (below the predicted rate of inflation) for each of the five years. Other classes would see an increase in some cases significantly above inflation.

The Vulnerable Energy Consumers' Coalition (VECC) and SIA opposed the rate smoothing proposal, arguing that it promotes intergenerational inequity, adds interest and carrying costs, masks the actual increase in any one year, and is unnecessary because the effect on the distribution component of the bill would be immaterial. VECC argued that the unsmoothed increases for 2015 and 2016 are acceptable, and that there is no evidence that customers want to pay additional costs to achieve rate smoothing.

Findings

The OEB's overall finding is that the revenue requirements and rates approved in this application will be in place for a three year period. The OEB will not approve the rate smoothing scheme as requested. The OEB considers that the rate smoothing would only have a minor effect on rates over the three year period. The OEB directs that rate mitigation be applied for customers in rate classes that experience undue rate impacts, that is, an increase from all causes greater than 10% on the total bill. The OEB will condition its rate approvals accordingly, when the Draft Rate Order is filed.

10.0 LOAD FORECAST

OEB staff and intervenors generally accepted Hydro One's load forecasts and the underlying economic forecasts. Hydro One's history of accurate load forecasting was noted by staff and several intervenors, but VECC, supported by Consumers Council of Canada (CCC), argued that there were major flaws in Hydro One's CDM forecast. For example, VECC submitted that the CDM report did not track actual CDM achieved or the difference between forecast and actual CDM effects. VECC urged the OEB to require Hydro One to undertake a proper evaluation of CDM results, and ensure that the definitions of forecast CDM are the same as the definitions used in tracking CDM results actually achieved. VECC also suggested that Hydro One's forecast CDM savings should be adjusted by using the OPA's draft target for the impact of future programs, prorated over the five year period. Hydro One responded that its CDM forecast is reasonable and supported by the evidence, and that the OPA forecast was too preliminary to be used to adjust Hydro One's forecast.

Findings

The OEB is persuaded by the historical accuracy of Hydro One's load forecasting and the support shown for the forecasts by many parties. The OEB acknowledges the arguments of some intervenors regarding the CDM portion of the load forecast; however the OEB is not persuaded that these perceived flaws have a significant impact on the overall forecast for the 2015 to 2017 period. The OEB finds that Hydro One's load forecasts are appropriate for the time period approved in the Decision.

11.0 COST ALLOCATION AND RATE DESIGN

Hydro One proposed a number of changes in the areas of cost allocation and rate design including the addition of a new unmetered scattered load class, changes to the definition of seasonal customer class, incorporation of the results of a rate class review, narrowing the revenue to cost ratio ranges for all classes and increasing the revenues collected from fixed charges.

Hydro One noted that some of the company's proposed changes in cost allocation and customer classification are significant, and may have a greater impact on some customers than the requested increase in revenue requirement. Although the company is neutral regarding cost allocation and rate design (because the full revenue requirement is recovered through the various rates and charges irrespective of the rate design and allocation of costs), Hydro One stated that in the interest of fairness to customers, the company's proposals are designed to align cost causality and cost recovery. Hydro One also considered bill impacts, and submitted a rate mitigation plan for some customers moving from one class to another as part of the rate class review. A summary of the company's proposals was presented in Exhibit G1/Tab 1/Schedule 1.

Lastly, the City of Hamilton raised a specific issue with respect to street lighting charges. The OEB addresses each of these proposals individually below.

11.1 Rate Class Review

Hydro One undertook a rate classification review using a Geographic Information System (GIS) tool to identify clusters of customers that may require reclassification, and to verify in general that customers were properly classified according to density. Hydro One proposed to implement the results of the study, which would reclassify 11% of its customers. This would, in turn, require a 3.4% increase in revenue collected from all other customer classes to make up for revenue lost due to reclassification to higher density classes. Hydro One proposed to repeat the reclassification review every five years, but use the GIS tool to monitor density changes that may prompt reclassification on an ongoing basis.

Intervenors generally supported the results of the review and the reassignment of customers between classes. However, VECC suggested that some mitigation of the resulting impacts may be required in 2016 if some of the impact in 2015 is shifted to the following year. The School Energy Coalition (SEC) noted that the absence of a medium density class for general service customers means that many schools are classified as rural, although they are situated in towns, and may be overpaying for their electricity service.

OEB staff (supported by CCC and VECC) suggested that Hydro One should perform another customer classification review in three years, and move to a five year cycle if the three-year review does not show the need for material levels of reclassification. In addition, staff recommended that Hydro One report to the OEB annually on complaints related to density and subsequent reclassifications, to determine if the GIS-based monitoring is lagging actual system characteristics. Hydro One submitted that both a shorter time frame for review and the tracking and reporting of complaints would consume considerable resources for little benefit, as the GIS tool will capture any data that would prompt reclassification.

Findings

The OEB accepts the results of the rate classification review for the purpose of setting Hydro One's rates for the next three years. The OEB agrees that a five year cycle of review and reclassification may be appropriate for the company in the future, but given that rates are set for three years in this Decision, the OEB will require Hydro One to report on an updated customer classification in its next rates application. The OEB finds that customer reclassification resulting from the rate classification review (as opposed to reclassification prompted by customer inquiries or complaints) can be implemented on a going forward basis as of the date of the implementation of rates resulting from this Decision. Retroactive reclassification from January 1, 2015 is not required where the reclassification is prompted by the rate classification review.

The OEB expects Hydro One to implement a rate impact mitigation plan. Hydro One proposed that mitigation take place for those customers who experienced a 15% or greater total bill impact as a result of movement to another rate class. However, the OEB does not accept this level of rate impact caused by reclassification alone. The OEB directs mitigation to be applied to those customers who experience a total bill

impact greater than 10% in total as a result of the application of all elements of this Decision.

11.2 Revenue to Cost Ratios

Hydro One proposed to move all customer classes to a revenue to cost ratio range of 98% - 102% over the five year plan, submitting that improvements to its cost allocation process support this narrow range. The status quo revenue to cost ratios for the Hydro One customer classes ranged widely from 129% in the Residential Urban class to 72% for the Sub-Transmission class.[24]

However, the company acknowledged that the movement to this range has the largest impact by rate class in 2015 of any of its proposals, and that pacing of the change may be required to mitigate the rate impact.

OEB staff and several intervenors (e.g. CME, Energy Probe) submitted that Hydro One should aim for a wider range in the ratio, for example 95 – 105% for all classes, and phase in this less dramatic change over the five year plan. VECC (supported by CCC) argued for an even broader range of 90 – 110%, submitting that the degree of improvement in Hydro One's cost allocation methodology was insufficient to support a narrower range.

Findings

The OEB agrees with VECC, and is not persuaded that the improvement in cost allocation methodology is sufficient to support the narrow 98 – 102% range. The OEB directs Hydro One to move its ratios to 90% - 110% over the three year period for which rates are approved. At its next rates application, the company may choose to propose further narrowing of the range.

11.3 Increase in Fixed Charges

Hydro One's rates include a fixed charge component and a variable charge component. Hydro One proposed to increase the proportion of the revenue collected through the

[24] Exhibit G1/Tab 3/Schedule 1, p.16

fixed charge and decrease the proportion of the revenue collected through the variable charge for all classes, to be consistent with an updated minimum system study that recalculated the peak load carrying capacity adjustment using detailed feeder data. The proportion to be collected through the fixed charge rises from 40% to 42% across all classes, although some classes (such as distributed generation) see larger increases in the fixed charge. Hydro One indicated that the increase in the portion of revenues earned through the fixed charge is more consistent with cost causality, and is unlikely to have a significant effect on conservation as the change affects only 13% of the total bill. OEB staff and some intervenors supported the proposed change.

Several intervenors opposed the change as discouraging conservation. The Green Energy Coalition (GEC) filed evidence from Dr. W. Marcus, which supported the arguments that the increase would reduce conservation gains and have a disproportionate impact on low energy use customers, who tend to be lower income customers. GEC pointed out that such effects would be contrary to government policy. GEC proposed that any change to the fixed charges should await the conclusions of the OEB's generic rate design review (EB-2012-0410).

SEC and the Federation of Ontario Cottagers Associations (FOCA), among others, supported the idea of waiting for completion of the OEB's review. VECC argued that the basis for the calculation of the fixed charge was flawed, and the current fixed variable split should be retained for residential rate classes (except for the seasonal rate class).

Findings

The OEB approves Hydro One's proposal to increase the amount recovered through the fixed charge from 40% to 42% across all classes. The overall change is minimal. While the OEB recognizes that some classes will experience a much higher increase in the fixed charge than 2 percentage points, the OEB accepts Hydro One's argument that the change will better reflect the actual cost to serve those classes.

11.4 Seasonal Rate Class

Issues surrounding the seasonal rate class received considerable attention in the hearing. Hydro One proposed in its evidence that about 11,000 seasonal customers

move to the R1 and R2 rate classes, because the consumption pattern of these higher-use seasonal customers was similar to customers in the residential classes. However, R2 customers presently receive a Rural and Remote Rate Protection (RRRP) subsidy. Eligibility for that subsidy is defined on the basis of residency under Ontario Regulation 442/01under the *Ontario Energy Board Act, 1998*. For practical reasons, Hydro One proposed to use monthly consumption patterns as a proxy for residency, and provide the subsidy to the new customers in the R2 rate class without a specific inquiry into their residency status. Intervenors who addressed this issue and OEB staff all argued that Hydro One could not avoid satisfying the residency criteria in the regulation, and that seasonal customers moving to the R2 class would have to satisfy those criteria or not receive RRRP.

VECC and CCC also did not support Hydro One's proposal, and argued that further study was needed before a solution to the inequities existing in the seasonal class could be reduced or eliminated. CCC suggested that density based sub-classes might help, while VECC submitted that a principled approach, taking account of load profiles as well as consumption patterns, could better reflect cost causality. VECC suggested using the proportion of revenues recovered through fixed and variable charges to address the cross-subsidy between high and low volume customers. Mr. Hurley recommended that seasonal customers pay for service only in those months when they are using electricity.

Hydro One supported the continuation of the seasonal rate class on the basis that seasonal customers do display different consumption patterns and load profiles than those of residential customers. However, the Balsam Lake Coalition (BLC) argued that the original justification for the creation of the seasonal class was obsolete, given the development of density-based rate classes. BLC submitted that the existing seasonal class is not based on factors directly relevant to cost, as customers with identical cost drivers and consumption patterns may be in different rate classes. Elimination of the seasonal class and distribution of its members to density-based residential classes would, in BLC's submission, more properly reflect density weightings for the members of the class and reduce within-class cross-subsidy caused by volumetric rate design. BLC acknowledged that the impact on low-volume seasonal customers would be high, but the impact could be phased in over a five year period. FOCA and OEB staff did not support the elimination of the class due to rate impacts on lower use customers.

In response to the almost unanimous rejection of its proposal by intervenors, Hydro One withdrew its request to change seasonal rates and submitted that no further review of seasonal rates would be helpful.

Findings

The OEB finds the arguments of BLC to be persuasive. Hydro One has developed the technical capability to implement and maintain density-based rates for its non-seasonal residential classes. These classes are defined by their geographic location in relation to the amount of distribution system assets that are required to serve each customer. The OEB considers the relative use of distribution assets to be a significant and predominant cost causality driver for the establishment of residential rate classes. The OEB agrees with BLC that the existence of density-based rate classes erodes justification for the retention of the seasonal class. The OEB finds that the seasonal class should be eliminated for rate setting purposes. Existing seasonal class customers shall be placed in a residential class according to their density.

The OEB considered the proposal of VECC and others that further work be conducted by Hydro One to compare the load profiles of customers within the seasonal class and residential classes, at various usage levels, to determine if they are sufficiently similar to combine into one or more classes. The OEB recognizes the practice of considering load profiles and consumption patterns in creating rate classes, but the OEB also recognizes that load profiles and consumption patterns will inevitably differ to some degree between customers within any rate class. Given the significance and predominance of the density cost causality characteristic the OEB is not convinced that the load characteristics of seasonal customers are sufficiently different from their neighbours in the residential classes to justify the continuation of the seasonal class.

The OEB agrees with the submissions of OEB staff and others that Hydro One cannot apply the RRRP subsidy to new entrants to the R2 class without determining their residency status in accordance with Regulation 442/01.

The OEB is aware that the elimination of the seasonal class will cause rate impacts, particularly for lower volume seasonal customers. At the same time, the OEB is mindful of BLC's submission that this group of customers is not paying the full costs of the

service they receive. That said, the OEB wishes to mitigate any large impacts to seasonal customers.

The OEB requires Hydro One to bring forward a plan for the elimination of the seasonal class. The plan should propose a phase-in period for those customers expected to experience a total bill impact of greater than 10% as a result of migrating to another class. The Board will conduct a hearing to examine the rate mitigation issues in the plan with the intent to implement the initial rate changes January 1st 2016. Hydro One should submit its plan to the OEB and the intervenors of record in this case by August 4, 2015. Hydro One should also propose what it considers to be an appropriate billing frequency for the customers that own secondary residences for consideration along with the hearing of the other matters.

11.5 Street Lighting Class Rates

The City of Hamilton, a street lighting customer of Hydro One, noted that the street lighting rates would increase by approximately 22% in 2015 under Hydro One's proposed rates schedules, and that the OEB had initiated a consultation related to cost allocation for street lighting customers. The City of Hamilton asked the OEB to include in its decision a provision for re-opening of Hydro One's application if there are changes to OEB policies that affect the costs and revenues allocated to the street lighting customer class. Hydro One objected to the idea of putting cost allocation for these customers on hold awaiting the completion of the OEB's consultation, and suggested that should the OEB's cost allocation model be modified, the rates for the street lighting class could be updated at the time of Hydro One's annual adjustments.

VECC submitted that traffic lights should not be included in the street lighting class, as traffic lights operate 24 hours a day, unlike street lights, which operate only during periods of darkness. Hydro One indicated that only about 1% of the lights in the street lighting class are traffic lights, and that to create and maintain two separate accounts for the two different types of lights would be inefficient.

Findings

The OEB agrees with Hydro One that finalization of the rates in this application should not await the completion of the consultation on street lighting. The OEB will not at this time create a specific provision for the re-opening of Hydro One's rates for adjustments related to cost allocation for street lighting.

As noted by the City of Hamilton, a consultation process has been initiated by the OEB under file number EB-2012-0383. When this consultation is complete, the OEB expects Hydro One to apply to adjust its street lighting rates at the earliest opportunity during which rate changes are being considered (i.e. during the review of the 2016 Seasonal Rate Class proposal, or the next complete rates filing if the consultation is not completed at the time of seasonal rate class review). The OEB may also provide generic direction on the basis of the outcome of the consultation.

With regard to traffic lights, the OEB agrees with Hydro One's argument, given the immateriality of traffic lights within this class.

11.6 Unmetered Scattered Load Class

Hydro One proposed the creation of a separate Unmetered Scattered Load (USL) rate class as a result of the direction of the OEB report *Review of Electricity Distribution Cost Allocation Policy* issued March 31, 2011. Previously, these customers were General Service energy (GSe) customers with a reduced monthly fixed charge to reflect that USL customers do not have any metering related costs.

Findings

No party opposed the creation of this new class in the hearing. In the OEB's view, the creation of this class should make it easier to consider cost allocation matters that are specific to the characteristics of the class. The OEB approves the creation of an unmetered scattered load class.

11.7 Line Loss Study

Hydro One engaged Navigant Consulting to track the variances between OEB-approved losses recovered in rates and actual line losses. The resulting study showed that actual

losses tracked OEB-approved amounts reasonably well. Consistent with a study recommendation, Hydro One proposed new loss factors for its rate classes to reflect more accurately the losses that occur as a result of delivery of electricity to those classes.

The evidence in this proceeding indicates that there is a reasonable match between amounts recovered in rates for line losses and actual losses on Hydro One's system.

The Ontario Federation of Agriculture recommended that Hydro One increase its efforts to reduce line losses and urged the OEB to initiate a working group to study the issue. While the OEB appreciates that reduction of line losses is a desirable goal, the OEB will not initiate a working group to study the issue at this time. The OEB expects Hydro One to work continuously to lower line losses as it invests in its system.

11.8 Miscellaneous Service Charges

SIA raised a concern that Hydro One's charges for miscellaneous services significantly under-recover the true cost of the services. SIA suggested that the charges should be updated to more closely reflect actual costs, which would offset some revenue to be collected from rates. While Hydro One agreed that the charges under-recover costs, the company submitted that the charges are consistent with the OEB's rate handbook, and that a review of the charges should be undertaken on a generic basis. The OEB has indicated that it will initiate a review of service charges in the distribution sector. However, as Hydro One has unique service characteristics, the OEB directs Hydro One to file, as part of its next rates application, a study assessing whether its service charges reflect Hydro One's underlying costs and to propose changes accordingly. Hydro One's study is to be informed by any available OEB guidance that results from the generic review.

12.0 SMART METER COSTS

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 to 2014. Hydro One's request for recovery of its historical smart meter costs (recorded in accounts 1555 and 1556) was opposed by OEB staff and several intervenors.

OEB staff noted that the average cost per installed smart meter for Hydro One was $568 (combined capital and OM&A over the 2006 to 2014 period), which is significantly higher than for other distributors. Staff provided examples of four other distributors that staff submitted face issues of low density and remoteness at levels similar to Hydro One. OEB staff submitted that Hydro One had not justified the recovery of the significantly higher costs per meter, and urged denial of full recovery of the costs. Staff suggested recovery of a per meter cost of $484, which would be 20% higher than the highest previously-approved cost for smart meters for these four distributors.

Some intervenors supported staff's proposed reduction, but others argued that the evidence on the record is insufficient to allow recovery, or to support a specific reduction. These intervenors proposed a separate proceeding be convened to fully review these costs.

In its reply argument, Hydro One resisted any reduction in recovery of the historical costs of its smart meter program. Hydro One argued that the costs of its smart meters have been audited and represent actual costs prudently incurred. The smart meter program was mandated by government policy and was not discretionary.

Hydro One indicated that the early installations (2006 to 2008) involved a large number of meters as they focused on high-density, easy to reach, mostly residential customers, while the 2009 to 2014 installations were for rural and low-density customers which involved significantly higher costs. Hydro One also submitted that the scope of work undertaken in the 2009 to 2014 period included communication reinforcement requirements for meters installed during the earlier period. This work was necessary to meet the minimum standards for billing and to improve meter reliability.

Hydro One emphasized that the fact that its costs are higher than those of other utilities does not mean that they are imprudent. Hydro One gave examples of the challenges it faced that are not faced by other distributors, and explained why the comparison to the utilities listed by OEB staff is not valid. Hydro One argued that staff's suggestion of a cap on costs of 20% above the highest cost for another utility is unreasonable and contrary to well-established rate making principles. Hydro One submitted that the OEB can only disallow actual costs already incurred if the costs are found to be imprudently incurred, and there is no evidence of imprudence in this case.

Hydro One also indicated that negative financial consequences would result if the recovery of regulatory assets that have been incurred is denied. Such a denial would affect Hydro One's risk profile and lead to a credit downgrade and an increase in borrowing costs, according to Hydro One. Hydro One submitted that this danger is particularly acute since the nature of the 2009 to 2014 smart meter costs is similar to the smart meter costs previously approved by the OEB for the 2006 to 2008 period.

Findings

The OEB recognizes that the smart meter program was mandated by government policy and was not discretionary. However, that does not mean that any level of cost incurred by a distributor to carry out the installation of smart meters is necessarily prudent. These costs are held in a variance account, and had not been considered by the OEB prior to this application. No utility is guaranteed recovery of amounts recorded in deferral and variance accounts. The onus is on the utility to demonstrate that the costs were reasonably incurred based on what was known or ought to have been known when it incurred the cost. As noted in section 2.8 of the OEB's Filing Requirements, the final determination of the prudence of costs recorded in an account will be made at the time of disposition of the account.

Hydro One's smart meter costs are significantly higher than other distributors. However, the OEB agrees with Hydro One that the fact that its costs are higher than those of other utilities does not necessarily mean that they are imprudent. Hydro One's service territory is low density and presents challenging terrain. The OEB recognizes that in the 2009 to 2013 period, Hydro One faced particular challenges in its service territory related to a need for investment in communications and accompanying

infrastructure. The OEB does not consider the circumstances that Hydro One managed in the implementation of its smart meter program to be comparable to the examples of others distributors provided by OEB staff. The implementation of the smart meter program involved travel to every residential customer dwelling in the province. The OEB therefore considers the customer-to-service area ratio to be a very significant distinguishing cost driver for individual utilities. Hydro One's low density customers make up a much larger percentage of its total customer population than other distributors in the province. Many of Hydro One's seasonal customers are in hard to reach locations such as water access only properties, contributing to much higher implementation costs.

Given the significant difficulties of the implementation of Hydro One's smart meter program, the OEB does not consider the significantly higher average cost to be unreasonable. Therefore a separate proceeding to review the smart meter costs is not required. The program has been completed and the information presented in this application has sufficiently informed the OEB.

Considering all of these factors, the OEB will allow the recovery of these costs as submitted.

13.0 DEFERRAL AND VARIANCE ACCOUNTS

Hydro One proposed the discontinuance of eleven deferral and variance accounts[25], the recovery of the $33.2 million balance in 16 accounts over five years[26], and the continuance of several other accounts. These proposals were unopposed. Hydro One also proposed the creation of two accounts to deal with bill impact mitigation and rate smoothing. The issues of bill impact mitigation and rate smoothing are dealt with elsewhere in this Decision.

Findings

The OEB approves Hydro One's requests regarding the deferral and variance accounts described above with the exception of the creation of the rate smoothing account, as it will no longer be required. The OEB also approves the disposition of the $33.2 million and finds that the recovery period will be three years rather than five years. The OEB has considered the increased total bill impact of a three-year recovery as compared to the five-year disposition period on an average residential customer and considers it to be acceptable.

As indicated in its evidence,[27] Hydro One will apply to the OEB for disposal of its RSVA accounts when disposal thresholds are met.

13.1 Restatement of balances

OEB staff asked that the OEB require Hydro One to restate the balances in accounts related to renewable generation connection and smart grid using the method prescribed in the OEB's Accounting Procedures Handbook (APH), to ensure consistency across the industry. However, Hydro One submitted that its approach was more transparent than that in the APH, and therefore no restatement should be required.

[25] Exhibit F1/Tab1/Sch2 and Reply Argument, pages 71 and 72.
[26] Exhibit F1/Tab1/Sch1/p3 and Reply Argument, page 73
[27] Exhibit A/Tab 4/Schedule 2, p. 3

Hydro One also took the position that the OEB-issued model cannot accommodate its circumstances. Hydro One stated that its methodology takes into consideration the timing of the projects, the cost of capital, depreciation and tax impacts, whereas the APH does not. In addition, according to Hydro One, the APH does not distinguish between capital expenditures and in-service capital additions, which are different concepts.

Findings

The OEB finds that there are no compelling reasons to require Hydro One to restate its balances using the APH method at this time as it may not appropriately accommodate Hydro One's specific circumstances.

14.0 DISTRIBUTION SYSTEM CODE EXEMPTION (EB-2014-0247)

Hydro One requested an exemption from the Distribution System Code sections 7.5.1 and 7.5.2. Section 7.5.1 sets out the obligations on a distributor to attempt to contact customers if a service appointment is missed or is going to be missed, and to attempt to contact the customer to reschedule the appointment within one business day of the missed appointment. Section 7.5.2 indicates that the requirements in section 7.5.1 must be met 100% of the time.

Hydro One submitted that it cannot meet the 100% requirement due to the fact that the geography of its service territory includes areas with gaps in communications infrastructure. It also claims unforeseen re-deployment of staff to power outage calls, managing its employee's priorities in relation to customer communications and unexpected emergencies involving staff reduce the ability of the company to meet the 100% standard. Hydro One has requested that the company be permitted to meet the requirements in section 7.5.1 90% of the time. It indicated that its target is to meet the requirements 95% of the time.

The OEB granted an interim exemption to Hydro One on September 8, 2014, the opening day of the oral hearing.

Parties who made submissions on this issue held varying opinions on whether the permanent exemption should be granted. Hydro One and two intervenors noted that Hydro One is not the only distributor that fails to meet this metric, and that many distributors fail to report their lack of compliance, according to the OEB's 2013 Yearbook. SIA submitted that this metric should not be tracked, as it affects a very small fraction of customers. Several parties, including OEB staff, supported a generic review of the standard in section 7.5.2.

Findings

The OEB finds that Hydro One has failed to demonstrate, with the evidence provided in this proceeding, that a permanent exemption should be granted.

The intent of the 100% standard is to minimize, to the extent possible, the negative impact on a customer who is going to be inconvenienced by the distributor's failure to meet a scheduled appointment.

Based on historic records of the number of appointments in a year, approximately 2,500 Hydro One customers per year could be affected if the proposed 90% compliance level is accepted by the OEB. In other words, potentially 2,500 customers that have made arrangements to be available (possibly incurring monetary expense) may not be contacted when Hydro One personnel realize they can't meet the pre-arranged appointment.

A standard that provides an explicit allowance for even one customer to be exposed to this scenario could only be justified if no reasonable steps to avoid the situation were available. Hydro One provided evidence that there are several causes for its inability to meet the standard to date. Hydro One did not provide evidence attributing any specific frequency or percentage of the total incidents to any of these causes.

The 100% standard in section 7.5.2 requires that only an **attempt** be made to contact the customer prior to an appointment being missed and for rescheduling

The evidence that the geography of Hydro One's service territory includes areas that do not have full communication system coverage may be a valid reason for failing to meet the standard. The inability to communicate in the normal fashion with certain customers has a significant bearing on whether Hydro One could make a genuine attempt to contact customers in those areas.

However, no alternatives to traditional methods of communication were explored in the evidence, nor were any alternative performance protocols examined. The OEB does not know what percentage of the failures to meet the standard are the result of a genuine absence of communications infrastructure, nor what avenues have been explored to minimize these incidents.

The OEB does not consider Hydro One's other submitted causes for its inability to meet the expected standard to be of comparable merit. More rigid communication protocols and employee training to reinforce the importance of customer communication could reduce incidents of non-compliance not related to lack of communications infrastructure. It is understood that employees who have appointments with customers will, on rare occasions, become otherwise engaged on short notice. Given the importance of contacting the customer with this information, Hydro One should be able to devise appropriate communication protocols and safeguards to ensure an attempt is made to

contact the customer whenever possible. The evidence in this proceeding did not demonstrate that this had yet been done. This performance metric has been in place for a number of years, and company protocols and employee behaviour must recognize its importance.

The interim exemption granted to Hydro One on September 8, 2014 will expire 60 days from the issuance of this Decision.

15.0 RECOVERY OF LOST REVENUES

On December 18, 2014, the OEB issued a Decision and Interim Rate Order declaring Hydro One Networks Inc.'s current Board-approved Tariff of Distribution Rates and Charges interim effective January 1, 2015.

The OEB has determined that the effective date for rates in this Decision is January 1, 2015, with an expected implementation date of May 1, 2015. Therefore, Hydro One is directed to calculate, as part of its draft Rate Order, the lost revenue for this period and to propose a rate rider to recover this amount over the remainder of this calendar year. The rate rider is to be a Monthly Fixed Charge.

16.0 SUMMARY OF DIRECTIONS FOR FILING

The following list is a summary of directions for filing contained in this Decision. Where any discrepancies exist between this list and the text of the Decision, the text in the Decision governs.

The OEB directs Hydro One to address shortcomings in its application as described in the Decision, including filing the following specific evidence as part of its next rates application:

- A total factor productivity study of Hydro One's own productivity, including data from 2002 and following years at a minimum.
- A compensation study similar to the study filed as part of this application to allow benchmarking to comparable companies.
- A comprehensive trend analysis of the vegetation management program showing year over year comparisons in unit costs.
- A best practices study, if undertaken, for vegetation management similar to the CN Utility study filed in EB-2009-0096.
- An updated depreciation study.
- A consolidated Distribution System Plan, with either an independent third party review of the Plan if conducted, or an explanation of the decision not to conduct such a review.
- Annual capital in-service additions, with explanations of any variance from approved levels (as required by the OEB Filing Requirements).
- An external benchmarking study on the unit cost of the pole replacement program.
- An internal trend analysis to show the variability of the unit costs of the pole replacement program year over year.
- An external benchmarking study on the unit cost of the station refurbishment program.
- An internal trend analysis to show the variability of the unit costs of the station refurbishment program year over year.
- A report on an updated customer classification review.
- A study on Hydro One's miscellaneous service charges, assessing whether the charges reflect underlying costs.

In addition, Hydro One is directed:

- To submit, by August 4, 2015, to the OEB and intervenors of record in this application, a plan for the elimination of the seasonal class, including recommendations for a phase-in period or other mitigation for customers expected to experience a bill impact greater than 10%, and a proposal for billing frequency.
- To apply to adjust its street lighting rates at the earliest opportunity during which rate changes are being considered.

17.0 IMPLEMENTATION AND ORDER

The OEB directs Hydro One to file a Draft Rate Order reflecting the OEBs findings in this Decision, complete with detailed supporting material, including:

- all relevant calculations showing the determination of the revenue requirements for 2015 to 2017;

- a schedule (or schedules) clearly showing the allocation of the revenue requirements from this Decision to the customer classes for 2015 to 2017,

- a schedule (or schedules) clearly showing the calculation of the rate rider that is to collect the lost revenue from January 1, 2015 to April 30, 2015.

- a schedule of final rates and all approved rate riders, including bill impacts (in a table similar to that filed at ExhibitG2/Tab4/Schedule1), and a calculation showing reconciliation of the total revenues by class to the revenue requirements.

- a detailed plan on how Hydro One will address rate mitigation that may be necessary when the approved rates are implemented.

- any other documentation that would assist Intevenors, OEB staff and the OEB in their consideration of the proposed Draft Rate Order.

The Ontario Energy Board Orders That:

1. Hydro One shall file with the OEB, and forward to all intervenors, a Draft Rate Order that includes all items listed above, including revised models in Microsoft Excel format as appropriate and a proposed Tariff of Rates and Charges reflecting the OEB's findings no later than **March 25, 2015**.

2. Hydro One will present its Draft Rate Order and supporting materials to OEB staff and Intervenors at a Technical Conference to be held on **April 1, 2015** in the OEB's hearing room at the OEB Offices at 2300 Yonge Street, Toronto beginning at 9:30 am. Hydro One should endeavour to have staff available to address any questions or comments provided by Intervenors or OEB staff.

3. Board staff and intervenors shall file any comments on the Draft Rate Order with the OEB with Hydro One no later than **April 6, 2015**.

4. Hydro One shall file with the OEB, and forward to intervenors, responses to any comments on its Draft Rate Order no later than **April 10, 2015**.

5. Hydro One shall file with the OEB and forward to intervenors a revised Draft Rate Order no later than **April 16, 2015**.

All filings to the OEB must quote the file number, **EB-2013-0416**, be made through the OEB's web portal at https://www.pes.ontarioenergyboard.ca/eservice/ ,and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at http://www.ontarioenergyboard.ca/OEB/Industry. If the web portal is not available parties may email their documents to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

ADDRESS

Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4
Attention: Board Secretary

E-mail: boardsec@ontarioenergyboard.ca
Tel: 1-888-632-6273 (Toll free)
Fax: 416-440-7656

DATED at Toronto, March 12, 2015

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary

18.0 APPENDICES

Appendix 1 –The Proceeding, Participants and Witnesses
Appendix 2 – Oral Decision on City of Hamilton motion, September 16, 2014

APPENDIX 1
THE PROCEEDING, PARTICIPANTS AND WITNESSES

THE PROCEEDING

On December 19, 2013, Hydro One filed an application with the Ontario Energy Board under section 78 of the *Ontario Energy Board Act, 1998,* S.O. 1998, c.15, Schedule B for an order or orders approving distribution rates for a five year period, commencing January 1, 2015.

The OEB issued a Notice of Application on January 24, 2014. In response to the Notice, the OEB received 19 requests for intervenor status. The OEB approved 18 of these interventions.

The OEB also received 13 Letters of Comment from ratepayers across Ontario, the vast majority expressing concern with the high level of the proposed rate increases. In addition, the OEB received resolutions from 42 Ontario municipalities, expressing concern over electricity rate increases.

Hydro One updated its pre-filed evidence in this case on January 30, 2014 and provided a further update on May 30, 2014. At the applicant's suggestion, the OEB held a series of three transcribed technical conferences on April 1, 10 and 23 and also held a transcribed session on May 12, 2014 during which Hydro One senior management made a presentation on the application.

The OEB approved an issues list for this case on May 20, 2014. Following an interrogatory process, a further technical conference was held on July 21 and 22, 2014. A settlement conference was held on July 28, 2014 but no settlement was achieved.

Motion and Decision

On September 4, 2014, the City of Hamilton filed a motion requesting an order freezing the rates of Hydro One for the street lighting class at 2014 levels or setting these rates as interim in this proceeding. The OEB heard the motion on September 12, 2014 and on September 16, 2014 gave an oral decision denying the motion. A copy of this decision is attached as Appendix 2.

The oral hearing for this proceeding began on September 8, 2014. On that date the OEB granted an interim exemption from section 7.5.2 of the DSC. The evidentiary portion of the hearing concluded on September 18, 2014. Hydro One presented oral argument-in-chief on September 24, 2014. The OEB received submissions from OEB staff and fifteen intervenors. The record closed with receipt of reply argument from Hydro One on October 27, 2014.

Decision on Interim Rates

On December 18, 2014, the OEB acknowledged that the OEB's decision may not be issued until after the proposed effective date of January 1, 2015 and declared Hydro One's current approved distribution rates interim as of January 1, 2015 pending the Board's final decision on the application.

In the decision on interim rates, the OEB also granted Hydro One's request to discontinue collection of revenue through the Regulation 330/09 renewable connection funding adder from provincial ratepayers as of December 31, 2014.

PARTICIPANTS

A list of participants and their representatives who were active either at the oral hearing or at another stage of the proceeding is shown below. A complete list of intervenors is available at the OEB's offices.

OEB Counsel and Staff (OEB staff)	Jennifer Lea, Harold Thiessen, Lisa Brickenden, Leila Azaiez, Keith Ritchie, Stephen Cain
Hydro One Networks Inc. (Hydro One)	Don Rogers, Anita Varjacic
Society of Energy Professionals (SEP)	Bohdan Dumka, Vicki Power

Consumers Council of Canada (CCC)	Julie Girvan
Canadian Manufacturers and Exporters (CME)	Emma Blanchard, Vince DeRose
Association of Major Power Consumers of Ontario (AMPCO)	Shelley Grice
Energy Probe Research Foundation (EP)	Roger Higgin, Brady Yauch
School Energy Coalition (SEC)	Mark Rubenstein, Jay Shepherd
Green Energy Coalition GEC)	David Poch
Vulnerable Energy Consumers' Coalition (VECC)	Michael Janigan
Power Workers' Union (PWU)	Richard Stephenson
Ontario Federation of Agriculture (OFA)	Ted Cowan
Individual Intervenor	Patrick Hurley
Federation of Ontario Cottagers Associations (FOCA)	John McGee
Balsam Lake Coalition (BLC)	Nicholas Copes, Michael Buonaguro
Sustainable Infrastructure Alliance (SIA)	Dionisio Rivera

WITNESSES

Eleven witnesses testified at the oral hearing.

Witnesses called by Hydro One (all Hydro One employees):

Susan Frank, Vice-President and Chief Regulatory Officer

Michael Winters, Senior Vice-President - Engineering and Construction

Glenn Scott, Director - Business Planning and Financial Support
Sandy Struthers, Chief Administration Officer and Chief Financial Officer
Samir Chhelavda, Director – Corporate Accounting and Reporting
Sam Amodeo, Manager - Productivity, ISD Support & NEB

Tom Irvine, Director – Network Operating Division
Paul Brown, Director - Distribution Asset Management Planning
Kelly Kingsley, Manager – Customer Care

Stanley But, Manager - Economics and Load Forecasting
Henri Andre, Manager - Transmission & Distribution Pricing, Regulatory Affairs, Corporate & Regulatory Affairs

Witnesses called by intervenors:

For the Ontario Federation of Agriculture: Ted Cowan

The Green Energy Coalition filed evidence but witness William Marcus did not appear at the oral hearing.

APPENDIX 2
ORAL DECISION ON CITY OF HAMILTON MOTION, SEPTEMBER 16, 2014
TR Volume 6, September 16, 2014, p. 98

RULING:

MR. QUESNELLE: As I mentioned before the lunch break, the Board has made a determination on the motion by the city of Hamilton heard on Friday, September 12th, 2014.

The city of Hamilton brought the motion for an order freezing the rates of Hydro One Networks for the street lighting class at the 2014 levels, for a period to be determined by the Board, or in the alternative, an order requiring that the rates for street lighting class, as they may be determined in EB-2013-0416, be interim and be reconsidered and, if necessary, reset following the outcome of the Board's considerations in EB-2012-0383.

The grounds submitted for the motion included the following:

> "In its report of the Board entitled 'Review of the Board's cost allocation policy for unmetered loads', EB-2012-0383, dated December 19th, 2013, the Board stated that: 'The revenue to cost ratio range for the street lighting rate class should not be narrowed unless there was sufficient evidence as to the correct methodology for setting street lighting rates, and further investigation was necessary before making a determination as to the allocation of costs to daisy-chain configured systems.'

The city of Hamilton submitted that those stated requirements for sufficient evidence and further investigation before setting rates for the street lighting class have not been fulfilled. The city noted that the Board has, by letter dated August 21st, 2014, given notice of its intention to undertake a study of, among other things, the appropriateness for the application of existing methods of cost allocation to various street light system configurations, and to update the Board's cost allocation model with

respect the cost allocation to various street lighting system configurations.

The city submitted that in light of the Board's statements in EB-2012-0383 and in light of the commencement of the study, it would be premature and unfair to the city of Hamilton to set HONI's rates for the street lighting class until the study has been completed.

No other party supported the motion. The motion is opposed by Hydro One, the Vulnerable Energy Consumer Coalition, School Energy Coalition, Canadian Manufacturers and Exporters, Consumers Council of Canada, and Board Staff.

In support of its motion, the city argued that the Board's report in EB-2012-0383 established that the Board's expectation that rates for street lighting services would remain unchanged until further investigation had been completed.

The Vulnerable Energy Consumers Coalition and some others submitted that the city's interpretation of the report is incorrect, and that the Board had simply determined that there was insufficient evidence to narrow the Board's revenue to cost ratio range for street lighting class for all distributors.

Those opposed to the motion also submitted that the Board routinely initiates policy considerations or policy reviews that have the potential to alter the rate-setting methodologies that are in place, and that the Board has not in the past set the current rates as interim or freeze rates in anticipation of a potential change to the rates. Those opposed to the motion submitted that to do so would be unworkable and result in ongoing uncertainty with respect to rates paid by customers of all rate classes.

The Board accepts the arguments of those opposed to the motion on both the interpretation of the Board's intent in the report of the Board, and the manner in which

the Board should deal with current rates during reviews of rate-setting policies.

The Board's report clearly states that the revenue to cost range should not be allowed due to lack of evidence that would suggest otherwise. The Board's various revenue to cost ranges were originally set in 2007 and have been narrowed for different classes at different stages as the cost allocation policy of the Board has evolved over time. The Board has not refrained from setting final rates, even though the ranges have been known to be in a state of flux. The Board considers certainty of rates paid at the time of system use to be a very important attribute of a fair and reasonable ratemaking scheme.

The Board will hear and consider Hydro One's evidence with respect to rates for the street lighting class, and make its determination giving due regard to the fact that a review of the class allocation methodology for street lighting has been initiated.

The motion brought by the City of Hamilton is denied.