

ONTARIO ENERGY BOARD

Hydro One Networks Inc. Transmission

Application for electricity transmission revenue requirement and related changes to the Uniform Transmission Rates beginning January 1, 2017 and January 1, 2018

INTERROGATORIES OF
CANADIAN MANUFACTURERS & EXPORTERS ("CME")
TO HYDRO ONE NETWORKS INC. ("HYDRO ONE")

1. HYDRO ONE'S NEW STATUS AS A COMMERCIAL ENTITY

CME 1

Ref: Exhibit A, Tab 3, Schedule 1, page 2 of 25

Hydro One refers to its "new status as a commercial entity". In this regard, The DBRS Ratings Report attached as Exhibit A-8-4, Attachment 3 states the following:

*...Compared with historical levels, DRBS expects [Hydro One Inc.] to pay out a higher portion of its earnings as dividends to support [Hydro One Limited's] dividend policy (payout approximately 70% to 80% of consolidated net income). The payout ratio at December 31, 2015 was 12.7% (excluding the \$800 million special dividend to the Province in Q4 2015) and 36% in 2014. DBRS expects [Hydro One Inc.'s] dividend payout ratio to remain high in order to meet [Hydro One Limited's] objectives to pay approximately 70% to 80% of its consolidated net income as dividends, and **consequently, in addition to high capital expenditure commitments, [Hydro One Inc.] will need to access significant external funding to finance the potentially sizeable free cash flow deficits expected over the medium term.***

- (a) Please explain how the above-described significant increase in dividend payout ratio will affect rates;
- (b) Did the above-referenced \$800M special dividend and/or the increased dividend payout ratio have any impact on Hydro One's capital investment strategy? Please explain.

- (c) Did the above referenced \$800M special dividend and/or the increased dividend payout ratio have any impact on Hydro One's long, medium or short-term financing strategy? Please explain.
- (d) Does Hydro One have an obligation to pay approximately 70% to 80% of its consolidated net income as dividends to its shareholders or can Hydro One elect to pay out a smaller amount. In what circumstances might Hydro One make such an election.
- (e) Please explain how the need to access "significant external funding to finance potentially sizeable free cash flow deficits" will affect rates.

CME 2

Please provide a copy of the prospectus which was produced in connection with the public offering of shares in Hydro One.

2. CUSTOMER SATISFACTION**CME 3**

Ref: Exhibit A, Tab 8, Schedule 1, Exhibit 1

Hydro One's 2015 Annual Report describes a class action suit in which the representative plaintiff is seeking up to \$125 M in damages related to allegations of improper billing practices relating to the rollout of Hydro One's new billing system. The lawsuit alleges that thousands of customers dealt with billing and administrative errors.

- (a) Are the costs of defending this lawsuit included in rates? If so, please describe how the costs are tracked and where specifically in the application those costs are included.
- (b) Has this matter been settled? If so, please confirm the settlement amount paid by Hydro One.
- (c) If this matter has been settled, is the settlement amount to be paid by Hydro One's shareholders or collected from ratepayers through rates? If the settlement amount is to be collected from ratepayers, please provide a rationale.

3. CAPITAL INVESTMENT STRATEGY**CME 4**

Ref: Exhibit B1, Tab1, Schedule 1, page 2

Hydro One states that it has "paced sustainment work so that critical work...could be completed in the next five years to ensure that transmission assets are in service before

expected outage constraints [associated with the planned refurbishment of large nuclear power plants] make work more difficult to complete.

- (a) Have the above-described expected outage constraints caused Hydro One to accelerate sustainment work which would otherwise have not been undertaken in 2016, 2017 and 2018? If so, please provide particulars including a list of accelerated projects and the capital cost of these projects.
- (b) Please quantify the financial impact of accelerating planned sustainment work.

CME 5

Ref: Exhibit B1, Tab 2, Schedule 4

Hydro One states that it made "significant investments in development capital from 2009 to 2012 to comply with government policy related to renewable energy and to increase system capacity to facilitate changes in generation mix....[and that] While this work was necessary to further energy objectives of the Province, **sustainment investments were deferred**":

- (a) Please provide a list of sustainment investments which were deferred and which are now proposed to be undertaken in 2016, 2017 or 2018.
- (b) Did any of the deferred investments relate to assets which failed between 2009 and 2016?
- (c) Was the cost of any of the deferred investments listed in response to question (a) above included in budgets which were approved by the OEB in previous rates applications? If so, please provide a reference to the relevant OEB decision.
- (d) Please provide the dates when the sustainment investments listed in response to question (a) would have been completed had they not been deferred (between 2009 and 2012) and provide a comparison of the costs to undertake such investments in the relevant year (between 2009 and 2012) and the estimated cost of completing such sustainment investments in 2016, 2017 or 2018.

CME 6

Ref: Exhibit B1, Tab 1, Schedule 3, page 27

Hydro One undertakes an annual detailed assessment of performance measures [equipment performance and delivery performance]. This assessment is taken into account along with other factors (such as asset condition) when establishing and prioritizing operating, maintenance and capital programs.

- (a) Has a field verified asset condition assessment been undertaken with respect to any of the assets planned to be replaced in 2016, 2017 or 2018? If so, please provide copies of the asset condition assessments. If not, please explain why not.

CME 7

Ref: Risk Modelling, Exhibit B1, Tab 2, Schedule 4, pages 6 to 7

Hydro One states that it “has not previously attempted to quantify reliability risk [and that] it has recently developed a system risk model to quantify and understand the reliability risk.” Reliability risk is used by Hydro One in its asset management process to gauge the impact of its investments on future transmission systems reliability. It is also intended to “provide a directional indicator to inform the appropriate level and pacing of sustainment investments:

- (a) How does the risk modelling described in the Application relate to the new Asset Analytics system which Hydro 1 implemented in 2012?¹
- (b) The Application and Evidence recommends “increasing the pace of replacements” (B1-2-4 at p. 14). Are there some investments which are now proposed to be undertaken in 2016, 2017 or 2018 which would not have been undertaken but for the information derived from Hydro One’s reliability risk model? If so, please identify those investments.

CME 8

Ref: Exhibit B1, Tab 2, Schedule 4, page 9

Hydro One is focusing on increasing the pace of replacing major power equipment as a result of significant equipment failures such as those which occurred at Elgin TS, Horning TS, Bridgman TS (Toronto) and Frontenac TS (Kingston):

- (a) Were any of the above-described stations listed as being in very poor condition in the Hydro One’s 2013-2014 rates application? If so, please identify those stations.
- (b) Were any of the above-described stations listed as being in very poor condition in the Hydro One’s 2015-2016 rates application? If so, please identify those stations.
- (c) Hydro One indicates that capital investments to refurbish Elgin TS were planned in 2015 and 2016. Have these works now been undertaken?

¹ 2015 Annual Report of the Office of the Auditor General – Hydro One Management of Electricity Transmission and Distribution Assets (the “Auditor’s Report”) at p. 249.

- (d) The Auditor General's Report² noted that Hydro One identified 34 transformers as rated "very high risk" for failure. Of this number, how many have now been replaced? Have any of them other than the four listed above failed?
- (e) How many of Hydro One's transformers are currently rated as very high risk for failure? How many of these are included in the list of the 49 transformers to be replaced in 2017 and 2018 (Exhibit B1-Tab 2-Schedule 6).
- (f) If the foregoing "very poor condition" terminology is no longer being used to describe asset condition, please advise what terminology is now being applied and whether it would produce a different list of assets requiring replacement in the near term.

CME 9

Ref: Exhibit B1, Tab 2, Schedule 6, page 36

This Exhibit includes the following table:

Conductor Portfolio	Historic				Bridge	Test	
	2012	2013	2014	2015	2016	2017	2018
KMs of Circuit Replacements	22	75	93	201	183	192	440
% of Fleet	0.1%	0.3%	0.3%	0.7%	0.6%	0.6%	1.5%

- (a) Please add columns to the above-referenced table which:
- (i) Correlate the number of KM's of Circuit Replacements undertaken in the Historic, Bridge and Test years with the net capital expenditures for transmission lines which we understand is found at Exhibit B1, Tab 3, Schedule 1, Attachment 1 (p. 1);
 - (ii) Derive a net cost per KM of line replaced for each year; and,
 - (iii) Illustrate the OEB approved capital expenditure for lines replacement for each of the relevant years.

CME 10

Ref: Exhibit B1, Tab 3, Schedule 2, page 36

Please add columns to Table 16: "Overhead Lines Component Replacement Programs (\$Million)" to show the OEB approved capital expenditure for each lines replacement program for each of the relevant years.

² Auditor General's report at p. 249.

4. PERFORMANCE/SCORECARD

CME 11

Ref: Exhibit B2, Tab 1, Schedule 1, Attachment 1

Hydro One has proposed a Transmission Regulatory Scorecard and has applied data collected between 2011 and 2015 to the proposed metrics:

- (a) The Scorecard suggests that between 2011 and 2015, System Reliability has improved or remained flat applying 4 out of 5 proposed metrics. The Auditor General cited “outages lasting 30% longer and occurring 24% more frequently when it concluded that “Hydro One’s transmission system reliability has worsened for the five years from 2010 to 2014.”³ Please reconcile these findings with the results reflected in the Scorecard.
- (b) The Auditor General identified a significant backlog of preventative maintenance orders for transmission system equipment, which increased by 47% from 3,211 order as of 2012 to 4,730 orders as of 2014. Please explain which of the proposed performance metrics would measure improvements in system maintenance.

5. COMPENSATION

CME 12

Ref: Exhibit C1, Tab 3, Schedule 3, page 2

Corporate Management Costs are increasing by almost \$17M between 2015 and 2017, an increase of more than 300% over two years, “due to increases in compensation”.

- (a) Please provide a breakdown of how the total annual amount allocated to Corporate Management for 2017 and 2018 is distributed amongst the Chief Executive Officer, the Treasurer and the Financial Officer;
- (b) Do Corporate Management costs include bonuses or the “long-term variable pay components” described in Exhibit C1-Tab 4, Schedule 1 (p. 17). If not, please describe the maximum amount by which these have the potential to increase compensation paid to senior management above the total Corporate Management Costs described at Exhibit C1, Tab 3, Schedule 3, page 2
- (c) Does the above-described increase relate in any way to the recent restructuring of Hydro One? If so, please explain.

³ Auditor General's Report at p. 248.

- (d) Corporate Management costs are described as including “General Counsel and Corporate Secretariat as advisors to the Board of Directors and corporate officers.” (Exhibit C1-Tab 3- Schedule 3 (p. 3)). Are such costs tracked separately from the \$10.4M and \$10.5M in General Counsel and Secretariat costs planned for 2014 and 2015 respectively?
- (e) Hydro One cites “higher General Counsel and Corporate Secretariat costs to address an increasing workload and greater complexity in the company’s legal matters” ((Exhibit C1-Tab 3- Schedule 3 (p. 2)). Is this as a result of Hydro One’s new status as a commercial entity? Please explain.

CME 13

Ref: Exhibit C1, Tab 4, Schedule 1, page 17

Please provide all documents or reports provided to Hydro One by Hugessen Consulting relating to the recruitment of a new CEO and CFO for Hydro One and appropriate compensation frameworks including the compensation market data provided to determine the target direct pay for the CEO and CFO positions. Please advise whether any of the four utilities cited as the primary reference group are Canadian utility companies.

CME 14

Ref: Exhibit C1, Tab 4, Schedule 1, pages 17 to 18

Please provide a copies of all materials prepared by Willis Towers Watson on behalf of Hydro One relating to compensation levels and design on behalf of Hydro One, including market assessments.

CME 15

Ref: Exhibit C1, Tab 4, Schedule 1

Hydro One has advised that a total compensation study for Hydro One will only be available for submission with the next Distribution Rate Application. What information is Hydro One able to provide in support of its current Transmission Rate Application in order to demonstrate how its compensation levels compare with those of it its peers.

6. NETWORK SERVICE CHARGE**CME 16**

Ref: Exhibit H1, Tab 2, Schedule 1

CME understands that the Network Service Charge (“NSC”) determinant provides time-of-use signals intended to encourage customers to shift their demand to off-peak usage. In this regard, customers are not charged NSC if they avoid consuming between 7 AM to 7 PM on IESO business days, which is the defined transmission system on-peak

period, unless the monthly peak demand occurs outside the 7AM to 7pm period, in which case the customer's NSC determinant will be their coincident peak demand.

- (a) Please provide a table that demonstrates how many times over the last 6 years the monthly system peak fell outside the 7 AM to 7 PM window. Please also identify the months where this occurred;
- (b) Does Hydro One agree that the original intent of the NSC was that coincident peak would occur in off peak hours? If not, why not?
- (c) Does Hydro One agree that while Ontario is a summer/winter peaking Province, during the spring and fall provincial power peaks generally occur later in the day? If not, why not?
- (d) Does Hydro One agree conservation efforts have resulted in monthly peaks occurring in off-peak hours, making it more difficult for manufacturing and industrial customers to predict when the peaks will occur? If not, why not?
- (e) What steps, if any, can manufacturing or industrial customers that operate between 7pm and 7am take to ensure that they do not operate during a coincident peak?