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Our File No. 163660

February 6, 2017

VIA RESS, EMAIL AND COURIER

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

Attention: Kirsten Walli,
Board Secretary

Dear Ms. Walli:

Re: EB-2016-0160: Hydro One Networks Inc. - BOMA's Final Argument

Further to the Board's extension letter dated February 3, 2016, please find enclosed herewith BOMA's Final Argument.

Yours truly,

FOGLER, RUBINOFF ~~LLP~~

Thomas Brett
TB/dd
Encls.
cc: All Parties *(via email)*

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EB-2016-0160

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

SUBMISSION OF

BUILDING OWNERS AND MANAGERS ASSOCIATION, GREATER TORONTO ("BOMA")

February 6, 2017

Tom Brett
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<u>Proposed Allocation of Tax Savings Created Through HONI's Exit from the PILs Regime and Entry into the Income Tax Regime</u>

This issue is of special interest to the Board, and the Board asked parties to make submissions on this matter.

Just prior to commencing the sale of the 15% of the Ontario government's interest in Hydro One Limited ("HONI"), HONI exited the PILs taxation regime, which it had been in since its creation, and entered the Canadian federal/provincial income tax regime. That shift endowed HONI with, inter alia, a new, very large, tax shield, in the form of the ability to take a much higher Capital Cost Allowance, in 2016, 2017, 2018, 2019, 2020, 2021, and likely many more years thereafter (some estimates are as long as twenty years). HONI used a "conservative" number of five years in its prospectus.

The tax shield windfall means that HONI Transmission and HONI Distribution will pay no corporate income tax in the test years (other than the minimum tax which is at a much lower level).

Notwithstanding the fact that it will pay no income tax because of the increased tax shield, HONI Transmission has included in its revenue requirement for the test years, on the amount of federal/provincial tax that it would have paid had it not acquired the increased tax shield. It is asking the Board to allow it to recover in test year rates a material amount of money - $70.5 million in 2017, $72.7 million in 2018 (J1.17), even though it will actually pay no income tax (other than the separate minimum tax, a very small amount).

HONI argues that this is fair because it incurred a cost to pay a "departure tax" when it exited the PILs regime (but before its 15% shares were sold to the public), and under the "benefits follow cost" principle, sometimes applied by regulators, it should be able to take the full benefit of the tax shield, and keep the entire incremental tax savings generated by the shield as income for the shareholder.

BOMA strongly disagrees for several reasons.

First, and most important, BOMA is of the view that HONI did not incur a real economic cost, when it "paid" the "departure tax" to the Province. The funds transferred to the Ontario government (via the Ontario Energy Financial Corporation), which the Province consolidates on its books, was immediately (at virtually the same time) returned to HONI by the government, in order to preserve HONI's equity for the imminent sale of its shares.

The substance of this matter is that HONI did not incur a cost; it was held whole by the government. Bear in mind that, at the time HONI became liable to pay the "departure tax" it was still consolidated on the books of the Government of Ontario, as was, and still is, the Ontario Energy Financial Corporation. The money was simply moved in a circular fashion, simultaneously, through three accounts, of the Government of Ontario, HONI to the OEFC, to the Ontario Finance Authority, to HONI.

Since HONI incurred no real cost, it is not entitled to the very real benefits. It should not be permitted to take from the ratepayers the benefits of the increase in the capital cost allowance claimed by the Company, which would normally accrue to them in the form of lower test year tax component of the cost of service.

Test year revenue requirement should reflect the true amount of the taxes forecast to be actually paid by the Company in the test year in question. That was the approach taken by the Board in RP-2004-0188.

Second, the Ontario government did not incur a cost when it returned the "departure tax" receipt to HONI at the time it still owned 100% of the shares of HONI, and the return of the funds to HONI's account ensured that HONI's equity would be maintained, to justify the sale price of the 15% of the government's shares.

The fact that the government did not incur a cost is confirmed, and that the funds simply moved in a circular fashion among three accounts of the Ontario government, by the government's testimony in the 2015 Estimate Committee hearings in October 2015, during the annual legislative review of the Estimates of the Ministry of Energy and the Environment. During the review, the following exchange occurred between Peter Tabuns, the NDP energy critic, and Serge Imbrogno, the Deputy Minister of Energy.

> "Mr. Peter Tabuns: OK, Mr. Imbrogno, you previously said that the $2.6 billion transaction from the Ontario Financing Authority to Hydro One and then on to the OEFC would be both <u>cash neutral and fiscally neutral</u> (our emphasis). Was this not correct?
>
> Mr. Serge Imbrogno: Yes.
>
> Mr. Peter Tabuns: I want to just get into that a bit further. This is a $2.6 billion contribution to Hydro One.
>
> Mr. Serge Imbrogno: That is correct.
>
> Mr. Peter Tabuns: So it's coming out of our treasury.
>
> Mr. Serge Imbrogno: Well it's fiscally neutral, because when Hydro One exited the PILs regime under the Income Tax Act, it makes a departure tax payment like any other corporation would. That's a $2.6 billion tax payment to the Province. To keep Hydro One whole, there is a $2.6 billion payment back to Hydro One, to maintain its capital, so it can optimize its valuation going forward.
>
> Mr. Peter Tabuns: So we're recycling the cash. It goes from our working capital to Hydro One. Hydro One pays it to the OEFC. I am assuming the OEFC isn't paying off debts, because if I understand you correctly, the cash comes back to the Ontario Financing Authority [Ontario government]. Is that correct?
>
> Mr. Serge Imbrogno: That's correct." [Page E419, Estimate Committee Proceeding of September 29, 2015]. The relevant pages from the Estimates proceeding are in Appendix A to this Submission.

This excerpt demonstrates that, notwithstanding HONI's statements to the contrary, neither HONI nor the Ontario government incurred any cost in connection with the "departure tax".

Second, Hydro One Limited (HONI) is the owner of 100% of Hydro One Networks Inc., a transmission and distribution monopoly regulated by the Ontario Energy Board, and 98% of the revenue of Hydro One Limited is derived from the income stream generated by the networks businesses. 85% of its assets are assets, the return on which is regulated. The regulated business constitutes almost all of the value of the group, and that revenue is provided by HONI's ratepayers. Accordingly, the ratepayers should keep the benefits a lower tax on that income due to windfall increase in the tax shield.

Third, Hydro One has recognized the weakness of its claim to the tax shield windfall as can be seen by the statements made in its 2015 Annual Report (p33), and repeated in its prospectus to comply with the true, plain and full disclosure requirement of securities legislation.

> "Risks Relating to Deferred Tax Asset
>
> As a result of leaving the PILs Regime and entering the Federal Tax Regime, Hydro One recorded a deferred tax asset due to the revaluation of the tax basis of Hydro One's fixed assets at their fair market value and recognition of eligible capital expenditures. Management believes this will result in annual net cash savings over the next five years due to the reduction of cash taxes payable by Hydro One associated primarily with a higher capital cost allowance. There is a risk that, in future rate applications, the OEB will reduce the Company's revenue requirement by all or a portion of those net cash savings. If the OEB were to reduce the Company's revenue requirement in this manner, it could have a material adverse effect on the Company."

Fourth, the issue of the "standalone principle" has no application here. HONI mentioned the principle in its evidence, but did not define it or explain in any depth why it should apply in these circumstances. BOMA's experience is that the "standalone principle" has been applied in the past to ensure that a utility neither subsidizes nor profits from the activities of a non-regulated business which is a division of the utility company. An example of the application of the principle from the past was the decision to, some years ago, remove the gas-fired water heater business from each of Union and Enbridge, rather than continue the debates about the appropriate principles of cost allocation (fully allocated versus incremental) and the appropriate rates charged by the utilities for the service and the wisdom of subsidizing a competitive business by ratepayers.

Fifth, and finally, the amount of "excess funds" that HONI would collect each year under their proposal is substantial (J1.3). At a time when rising energy prices are hurting ratepayers, refusing to allow ratepayers to benefit from the unexpectedly low test year income taxes, especially given the fact that HONI has overearned in each year in the last five years under cost of service ratemaking on average over 3% (300 basis points), above its allowed return. HONI is an A-rated utility. It does not need an even higher return.

Rate Increases to Unacceptable Levels

The amounts proposed to be included in the 2017 and 2018 revenue requirement are not appropriate as they (1) include amounts for taxes that should accrue to the ratepayers from lower corporate taxes in the test year due to Hydro One's the very large tax shield windfall due to its decision to move out of the PILs regime into the federal/provincial income tax regime; and (2) the proposed revenue rate increases are excessive at 4.2% in 2017 over 2016 and a further 5.2% for 2018 over 2017. This is compound rate of growth over the two test periods of close to 10% with no opportunity to address the second year increase prior to January 1, 2018, unlike a normal one year test period under a cost of service regime. The two year test period diminishes the opportunity for adjustments. This proposed revenue requirement increase is egregiously high and should be turned down by the Board. The proposed increases are on top of average increases of 3.2% over the previous few years. The average rate increase (via the Uniform Transmission Tariff) for the transmission connected customers to LDCs and 92 transmission connected end users is approximately 5% (Exhibit A, Tab 3, Schedule 1, p2). The increased rates to LDC customers are, of course, passed on, dollar for dollar, to their residential, commercial, and industrial customers.

These increases reflect a rapidly increasing revenue requirement, which is driven by substantial increases in rate base, depreciation, and return, in turn driven by accelerating capital expenditures, mainly for sustainment, through the bridge year and the two test years. The forecast revenue requirement (before offsetting revenues, which can vary widely from year to year) increases by a substantial $51.4 million in 2017 versus approved 2016 revenue requirement, an increase of 3.5% (Exhibit A, Tab 3, Schedule 1, p8, Table 3, line 5), and a further $79 million in 2018, an increase of 5% (Ibid).

Capital Expenditures Related Issues

Depreciation is forecast to increase by $38.4 million to $435.7 million in 2017 over 2016 Board approved of $397.3 million, and further to $470.7 million in 2018, increases of approximately 10% and 8%, respectively (Ibid).

Forecast total capital expenditures ("capex"), including sustainment, development, operations and common corporate capital costs, in 2017 are $1,076,000, an increase of $72.3 million, or 7.2% over the bridge year, and an additional $46.1 million in 2018, an increase of 4.5% over 2017 (Exhibit A, Tab 3, Schedule 1, p13, Table 5). The two year compound rate would be somewhat higher. Ninety percent of capex is sustainment and development capital. Development capital expenditures are largely driven by regulatory requirements, and costs of connecting new customers, and system improvements directed by the IESO. However, sustainment capital, the pacing of which HONI has much more control, is forecast to increase over the two year test year over 2016 Board approval, by $117.8 million, an increase of approximately 15% (Ibid).

Sustainment capital expenditures have accelerated rapidly from $389.3 million in 2012 to $724.3 million in the bridge year, to $776.8 million in 2017 and to $842.1 million in 2018. Furthermore, the Company forecasts the acceleration will increase in the remaining three years of the

Company's current five year plan, to $859.7 million in 2019, $915.2 million in 2020, and $1.18 billion ($118.1 million) in 2021. HONI transmission has spent $2.909 billion in sustainment capital in the last five years, plans to spend an additional $1.62 billion in the two test years, and a further $2.859 billion in the next three years of the plan (Ibid). The capex increases are too high. HONI has failed to prioritize and pace its sustainment capital investments in a manner to hold rate increases to a reasonable level.

Meanwhile, HONI forecast load is flat to declining. With Ontario load forecast (twelve month average peak in MW) forecast to decline by 2.6% in 2017 and 2018, relative to the 2016 Board approved demand forecast.

This disconnect between demand for its service and sustainment capital will continue to drive substantial rate increases not only in the test year, but for several years thereafter (Ibid). This acceleration of spending will drive higher rate increase over the same period. Part of the problem with HONI's perennial two year cost of service approach to ratemaking is that intervenors, the public, and the Board, do not have a clear view of the context for the proposed rate increases, including, in this case, further substantial capital expenditures proposed for the remaining three years, to the end of HONI's current capital expenditure plan. HONI even attempted to shield its 2019, 2020, and 2021 capital expenditures from scrutiny in this proceeding. HONI's evidence is that it maintains a rolling five year capital expenditure plan, which it updates annually.

However, this rapid increase in spending on sustainment capital through the bridge year has not achieved a corresponding increase in reliability of service. Moreover, HONI has earned far in excess of its allowed return on equity over the last five years. Moreover, rate increases of the size described above, particularly when unaccompanied by increases in reliability and power quality improvements, do not reflect consumers' needs and preferences.

HONI's proposal to retain for itself the benefits arising from its proposed deferral tax asset, acerbate the financial impact on consumers, who otherwise would have received an offset to an increase of revenue requirement in the form of lower test year taxes, as a result of deferral of some of the corporate income taxes otherwise payable.

These proposed increases are much higher than the agreed rate increases for 2015 and 2016, which were accepted by the Board, which were 1.1% in 2015 and 1.7% increase in 2016 (EB-2014-0140, Settlement Agreement, p5 of 27) after adjusting for the load forecast settlement, reduced from the 3.2% and 3.3% rate increases in HONI's original proposal. In the Agreement, the parties also agreed that revenue forecast would be based on the midpoint between the twenty year local trending information and the thirty-one year average local (HONI's preferred method). That change resulted in a 0.5% increase in the charge determinants used for calculating transmission rates, and a 0.5% decrease in the assumed rate impacts.

HONI's Customer Engagement Activities (Issue 3)

In order to conform with the Board's RRFE Principles and the Board's February 2016 Transmission Filing Guidelines, HONI carried out, for the first time, a consultation with its customers on its rates application. The consultation consisted of HONI's having one on one meetings with some of its direct connect customers, five consultative sessions with small groups of customers facilitated by IPSOS Reid, and an online questionnaire posted on HONI's website for customers to answer prepared questions.

While the consultation was a start, BOMA has a number of concerns with it.

First, the consultation was held late in the process. It started about eight to twelve weeks before the applicant filed its Application and ended shortly before the filing. It was too late to have any real impact on its Application. Mr. Penstone admitted this when he stated:

> "The customer consultations led to small adjustments to the draft optimized plan that we had provided. Optimization is the new final step in the Board's investment planning process". (Tr 5, p100).

At Exhibit B, Tab 2, Schedule 2, p11 of 11, HONI states:

> "Hydro One's Transmission System Plan [a major part of its Application] reflects its general assessment of customer needs and preferences. The investment plan takes customer engagement information into account as follows:
>
> • The plan mitigates the risk to current service levels posed by asset deterioration;
>
> • The plan supports Hydro One's ability to continue to provide first quartile reliability in a safe manner; and
>
> • The plan optimizes the life of assets to avoid unnecessary capital expenditures."

Whether one agrees with the investment plan or not, it is clear that the general points noted above were, and have been for several years, in HONI's view at least, incorporated into its investment plans and Rate Applications. They are not new priorities or inclusions generated by the customer consultation.

Second, the sessions were rather poorly attended, reflecting in part the hurried nature of the exercise. Two of the five group sessions had three and five attendees, respectively. Only twenty-eight customers filled out the online questionnaire.

While it went to some lengths to establish its bona fides as consultants, IPSOS Reid is known primarily as a survey firm. It admitted that the firm, including the two senior members that facilitated the discussion groups, had no substantive energy or utility regulation expertise.

With respect to the context of the material provided to the participants in the consultation, we have the following reservations:

- The forecast rate impacts did not include the impact of OM&A costs, new (decreased) load forecasts, or borrowing costs.

- The Company relied heavily on a tool, which it called a "reliability risk", that it developed in late 2015 and early 2016, in presenting the Application material to their customers.

- The Company did not give its customers an appropriate range of investment plan options.

BOMA believes the measurement/tool was developed mainly for the purposes of the customer consultation.

Reliability risk, as we understand it, is simply a number, which for a given class of assets, eg. transformer, breakers, conductors, shows increase in risk of failure of that class of assets in aggregate in the year following the year in which the reliability risk assessment is made.

It is built up from the hazard curves of individual assets, aggregated into a hazard curve for a class of assets. It, like the hazard curve from which it derives, is based solely on the asset's age, individually and as a class, and does not take into account the asset's condition. In effect, it is a way of showing the likelihood of failure of the group of assets in the test year, relative to the likelihood of failure during the base year (2016), taking into account only the one year increase in age. Reliability risk is not a very useful analytical or practical tool. It merely shows the increase in the likelihood of asset failure in the test year, compared with the previous year on some of HONI's assets, based on information on asset age alone. The Company stated many times that it was not a tool used in determining the actual investment portfolio. In other words, assets to be replaced or enhanced, or adjusted in the test year, would be chosen for a variety of reasons, including asset condition, impacts of their failure, specific customer needs and requests, among others, but the reliability risk has nothing to do with those choices.

As we will discuss below, the condition of the individual asset is the critical determinant of its likelihood of failure in the test year, and that does not always correlate closely with age. More complexity is added by the fact that the Company often does not replace many of, or only its assets in very poor or poor condition, in its investment plan. The composition of the investment plan reflects many other factors.

The Company put up three sustainment programs options – small increase in sustainment capital investment, the proposed sustainment capital investment, and a much larger sustainment reliability risk capital investment. They calculated the increase in the likelihood of failure, based on asset age only, for each of the three asset classes for each of the three investment scenarios.

As noted, they endorsed one of the three proposals – the middle one. They then forecast the revenue requirement and rate impacts of that proposal.

BOMA believes the Company's approach compromised the integrity of the consultation.

First, the Company did not provide a "business as usual" approach, that sustainment is capex consistent with the average levels of the last few years.

Second, the Company did not discuss the impact of each of the options on reliability performance.

Many of the customers consulted, while they appeared to grasp the idea of the reliability risk, were more interested in HONI's reliability performance, including power quality performance (our emphasis).

And the IPSOS Reid Report stated (p14):

> "...these same customers, as well as others, expect to see an improvement in actual reliability performance, not necessarily only a reduced reliability risk for this [the proposed investment in the Application] level of investment."

Notwithstanding the declared customer preferences, HONI has refused to guarantee improvement in actual reliability indices, or even set reliability (SAIDI, SAIFI) targets as part of its proposed scorecard.

Customers also expressed concerns with power quality (see IPSOS Reid, p14). HONI has taken some steps to deal with power quality, but they are very preliminary ones, given that power quality has been an issue of concern for many customers for some time.

The formation of a power quality working group, a seminar given by an expert in the field, and two small research projects or demonstration projects are not a sufficient response to a serious problem. HONI requires a plan of action to remedy these defects.

Both HONI and its contractor claim to have not retained the rank ordering of the issues raised by customers, and listed on p21 of the IPSOS Reid Report. Failure to do so is puzzling. They must have the data somewhere and should release it. The information would assist the Board to determine the extent to which the transmission plan reflects customer preferences.

BOMA was also concerned with some content of the presentation made by HONI at the one on one sessions, and the five roundtables, in particular, statements at p9 of the Appendix A to the IPSOS Reid Report (Appendix A was the HONI presentation package).

Under the title "Evidence suggests that underlying reliability risk is increasing", the Company states:

> "• Equipment outages caused by failure or necessary repairs/replacements increased about 300% from 2011 – 2015
>
> • Increased duration of customers normally served by a multi-circuit system having only single supply, increasing interruption risk by about 400%".

BOMA views the first statement, in particular, as alarmist, and misleading. While a footnote on p9 provides an explanation of sorts, it does not totally clarify the statement above. The focus should be on actual customer interruptions, including interruptions resulting from equipment failures including circumstances where the customer has lost the use of one line, as a result of repair, enhancement or replacement operations, on the other line.

The statement does not distinguish between the equipment outages and interruptions at delivery points, notwithstanding HONI's frequent references to it as a crucial distinction. Nor does it divide the equipment outages into planned and unplanned outages. Customers made it clear in the consultation that the impacts of the two types of outages were very different and material. Given proper notice, they could usually work around planned outages, but even very brief unplanned disruptions could wreak havoc with their operations, and impose substantial financial burdens.

Most of the material presented in HONI's presentation dealt with multi-circuit data, while much of Northern Ontario is on single circuit. The significance of this difference is demonstrated by the second sentence of the two quoted above, the one that states that interruption risk increase by 400% when shifting from two circuits to one.

HONI has not provided a plan to address much higher outages rates in the North, which the Auditor General and HONI pointed out, are many times higher than in the South. HONI should join with the IESO to develop a viable plan to increase service and reliability of HONI's service in the North.

Finally, HONI's frequent selective use of the terms "end of useful life", or "beyond its useful life" is confusing. For example, the data on p14 of the Presentation shows the percentage of conductors, steel towers, transformers, and breakers, which are described as "beyond expected service life". That term is defined in a footnote below as "the average time in years that an asset can be expected to operate under normal system conditions". However, these numbers are not consistent with the percentages of the asset group that are in poor or very poor condition. One would expect a correlation between an asset condition and its characterization as beyond its expected service life. At the very least, the Company should clarify that "end of useful life" and "beyond expected service life" mean the same thing, or if not, what is the difference. The more relevant numbers would be the apportionment of the assets into very good, good, fair, and poor conditions. The data should be used consistently in the various Company materials, so as not to confuse customers.

The Transmission System Plan and Transmission Investment Issues (continued)

As noted above, HONI's transmission plan and capital expenditures proposed does not address customer needs and preferences in that it places insufficient emphasis on improving actual reliability over the test years. HONI's customers have clearly stated that reliability performance is their highest priority.

It is clear from HONI's evidence that it is not in the first quartile reliability with respect to SAIDI. It is also clear from the most recent NAFT report that HONI is in the third or fourth quartile of reliability relative to its large utility US and Canadian peers. The Navigant/First Quartile Consulting Report shows the same results with respect to SAIDI. The Auditor General in its 2015 Report noted that HONI's reliability performance declined over the five year period 2010-2014.

Undertaking J7.4 shows that for the period 2011-2015, HONI's SAIDI is essentially flat, 525 sustained interruptions in 2015 versus 530 in 2011. The range of variance in SAIDI over the five year period was 512-544, a spread of thirty-two, or about 6% (in fairness, the number of momentary interruptions did decrease over the same period).

Notwithstanding its uneven record, and its apparent recognition that customers value reliability performance highly, HONI refuses to set a specific increase in reliability performance as part of its proposed scorecard, or as an internal performance indicator (KPI), or in its proposed team scorecard, that drives executives' variable compensation.

Nor has it altered its investment planning process, and capital expenditure portfolio to increase the importance of asset condition a driver of investments. It continues to weigh asset condition as one of many factors in selecting investments rather than focusing on first replacing all of its major assets that it has determined are in poor or very poor conditions.

For example, Undertaking J7.2 shows that HONI intends to replace 198 breakers in the two test years, but only 12 of the 198 breakers are in poor or very poor conditions. J7.3 was supposed to show how many of the breaker replacements were air-blast breakers, which can be viewed a s a special category because of the safety risk they pose to workers, but was recorded improperly, as the same as J7.2. Perhaps HONI would provide its answer in its Reply Argument.

But subject to taking into account the number of air-blast breakers it proposes to replace in 2017 and 2018, most of the breakers HONI proposes to replace are in fair, good, or very good condition. That seems inappropriate if maintaining reliability is really the principal driver of investment. A similar situation exists with the transformer fleet. HONI proposes to replace 49 transformers in the test years (Tr 7, pp102-104). HONI's evidence is that 15% of its transformers are in high risk or very high risk conditions (Exhibit B1, Tab 2, Schedule 6, p7).

It was not clear from the evidence whether all, or how many, of the transformers that HONI intends to replace in the test year were in the very high risk or high risk categories. For those transformers that are in fair, good, and very good condition, the reasons for replacement were not provided.

For conductor replacement, their evidence is that they use a sampling approach to assess conductor line conditions for any conductors in service for fifty years or more.

Their evidence was that they sampled each section of the conductor line, where a section could be anywhere from one kilometre to twenty kilometres in length. If the sample indicates the line is in poor condition, they replace the entire section (Tr 7, pp112-113).

The evidence is not clear on how many samples are take per section. Their evidence was:

> "So the way the engineering works is when we say one section, we are referring to that run of conductors [that] are subjected to the same kind of tensions and environmental factors and aging factors." (Ibid)

But that assumes that on a 20 km section of line, these factors would be identical. That seems improbable. It is not clear from HONI's evidence the extent to which conductor in fair or good condition is being replaced as a result of the "section by section" approach.

BOMA's concern here is that there is not sufficient focus on asset condition in the selection of investments.

First, HONI's investment planning process, while starting with an assessment of asset condition, uses a host of other factors to both determine the "investment candidate pool", and select from that pool the proposed investments.

The initial selection of the pool appears to be driven by the use of an "analytics tool" which covers six factors, one of which is asset condition. The factors are presented in evidence, but the weight assigned to each of the six factors are not, and the tool has been discredited by the Auditor General's 2015 Report (p259 of the Report; p2G of K7.2), and was the subject of recommendations made by the internal auditor to HONI (K4.3), which do not appear to have been acted upon. HONI has stated that it is working to improve the "analytics", and that it is a work in progress.

There is no clear description in the evidence of how the "analytics tool" actually works. Moreover, it is not clear what the optimization process does, whether it refines the pool of eligible investments or selects the investments that HONI proposes to implement in the test years, or both; and what other factors, for example, engineering judgement, specific customer preferences and concerns are used in either stage.

Nor is there any overall envelope within which senior management has directed the planners to work, for example, no cap on the amount of capital investment that the planners should propose. The only constraint in the selection and optimization process seems to be availability of human resources, to execute the work within the two year timeframe. For example, HONI proposes to replace 50% to 60% more transformers in each of the test years than it has done on average in each of the previous five years. There is no explanation as to how that number was selected, nor how the amount of capital dedicated to the replacement was determined.

While BOMA agrees with HONI's efforts to replace some of the faulty insulators, and to begin the long-term process of replacing air-blast breakers, and accelerating the tower coating program, it notes the Company's statement that the tower coating program is a lesser priority than the conductor replacement, and the insulators replacement program, and the replacement program will stretch over many years due to implementation constraints. However, it also agrees with Board staff that the defects in the Canadian Porcelain and Brass insulators have been known about for a very long time, remediation should have been commenced much earlier when indemnification from the vendors would have been more likely. Ratepayers should not have to pay for the replacements. It is not convinced that the remainder of the investment program has been properly justified, or that the three priority programs are properly paced. Only one insulator has fallen in a public space.

BOMA does not, therefore, support the substantial ramping up of the capital programs, while reliability issues remain outstanding. In fact, the investment plan reflects a substantial increase in sustainment capex without an indication of corresponding increase in reliability performance as a result of previous expenditures, before adequate prioritization and pacing principles are developed, and before the quality of the customer engagement is improved.

At the moment, the plan's link to customer needs and preference remains tenuous. In discussing the role of customer preferences in the investment plan (Exhibit B1, Tab 2, Schedule 4, p3), HONI refers to those projects which are originated by the customers that HONI responds to, and whose costs are shared with the customer (Tr 7, pp99-101). This type of single customer need is very different from the customer needs and preferences than the Board refers to in its RRFE principles with respect to the investment plan, as a whole, and the Company's business plan, as a whole.

Finally, HONI Transmission has not obtained a third party expert assessment of its assets' condition since 2008. With respect to the current Application, HONI stated that it did not have the resources to do both a third party condition assessment and a customer consultation prior to filing it. This claim is dubious. It would have been possible to commence the asset condition work much earlier. The likely answer is that HONI preferred to use its own resources, notwithstanding the fact that the analytics software it had purchased clearly was not working. They chose to try to repair it but continued to do the asset condition assessment internally. BOMA questions, given the importance of asset condition to reliability, why HONI would not have sought outside advice, after its 2015 experience, as outlined by the Auditor General and its own internal auditor.

Benchmarking Evidence (Issue 10) (Exhibit B2, Tab 2, Schedule 1, Attachment 1)

HONI has agreed that the Navigant Study is not a total factor productivity report (Tr 3, p12). You cannot draw a productivity conclusion from it.

The study does not use an econometrics approach; it uses a peer group approach which is very different. The Board has stated in previous cases that it prefers the economic approach rather than the peer group approach in benchmarking exercise.

The peer group for the study consisted of two Canadian companies (BC Hydro and Manitoba Hydro), and fourteen US utilities, most of whom were existing clients of First Quartile Consulting. (It is mostly based on data up to the end of 2014). The companies represent a wide cross-section of utilities of different sizes, and different geographic regions, almost all American[1].

The study dealt extensively with the reliability of HONI's system, relative to the peer group, using data from the CEA, and from the TADS data submitted to FERC. Its findings support other evidence (see above) on HONI's reliability performance.

HONI's frequency of sustained outages from elements below and above 200 kV were the highest and third highest in the peer group, respectively (Ibid, p21).

Even with the worst performing element removed, HONI had third and fourth worst performance, respectively, with respect to the above measure.

The Cause Code data shows:

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[1] Interestingly, the study notes the CEA has not provided reliability data from included Canadian utilities since 2009, as it decided the regulators were using the information in rates cases.

Relative to many other causes, lightning was not a dominant cause of sustained outages. Equipment performance and power system condition were the largest causes, and larger for HONI than many other companies (Ibid, p19).

The study benchmarked five items – cost, reliability, project management, safety, and staffing characteristics.

HONI's direct OM&A per asset, while trending down, is still in the fourth quartile of the fourteen companies (Ibid, p18).

HONI underspent relative to budget in 2010, 2012, and 2014. As there was no protection for ratepayers from underspending in those years, as there was in 2015 and 2016, the benefit of the underspending would have gone to the shareholders (Ibid, p22, Figure 27).

HONI's administrative and general costs per circuit/km are among the highest in the peer group (Ibid, p36).

HONI's favourable position on transmission line OM&A capex per asset figure (due to relatively low capex per asset) reflects, in part, the relatively flat growth HONI has experienced recently. The largest part of capital expenditures by far for most of the peer group was for network capacity additions (green colour on the graphs and bar chart). HONI's comparable growth driven capital expenditures were among the lowest leading to relatively low line overall capex. See, for example, Figure 16 (Ibid, p20).

In conclusion, the Benchmarking Study does not support the applicant's proposed Transmission Plan and related cost forecasts. The study is a hybrid study, comparing certain reliability and cost data, on the one hand, and a best practices study, which selects best practice ideas from the comparison of some aspects of HONI's operations with the way that some tasks are performed by other utilities in the peer group. It turns out not to be very good in meeting either objective, in part because the two objectives require different peer groups to achieve the best results. In addition, some of the cost comparison of the capex/asset variety require deeper analysis than the study provided and don't support the conclusion the Company seeks to draw from them.

Productivity Improvement and Performance Scorecard, Operation, Maintenance and Administrative Costs

HONI did not tender an OM&A Panel to deal with continuous improvement and productivity measures, other than the Policy Panel, which had many other responsibilities.

It did tender a panel on Execution, which covered productivity improvements in some areas, but not in others. Overall, the presentation on these issues was somewhat confusing. As well, many of the financial OM&A related tables were prepared by a Mr. Scott, who was not presented as a witness.

That said, BOMA is of the view that HONI has not justified its proposed level of OM&A expenditures for the test year.

First, HONI has overforecast its OM&A spending in four of the last five years, by an average of about 7%, $25 million per year ($103.6 million over the four years, 2012 to 2015) (I-13-25).

The OM&A underspending ($25 million per year) has included on almost every line item, in every year since 2012 (Ibid).

Aside from the overforecast/underspend, HONI's 2017 and 2018 forecasts would show a further $20 million annual increases over 2016, but for the increase in the offsetting revenue items on the OM&A forecast (Exhibit C2, Tab 2, Schedule 1, p2 of 2). The "other" items represent reductions in OM&A due to those revenues. Part of the increases in credits to the OM&A was due to an increase in capitalized overhead due to the forecast increase of capital expenditures in the test years, relative to the bridge year (a decrease in OM&A of $11 million per year). HONI has not disclosed what accounts for the remainder of the $20 million, although BOMA believes it may be the return of pension over contributions. The increase in credits offset what would have otherwise been further increase of $20 million per year, over 2016 OM&A. Table 12 at Exhibit C1, Tab 3, Schedule 3, p24 shows the breakdown of "Other" OM&A for 2017 and 2018 to be largely an increase in overhead capitalization. BOMA assumes the balance is maintained in the test year and renewed. This amount is calculated by applying a capitalization rate to the proposed test year capex. It is in effect, an incremental capitalization, reflecting an increase in capital expenditures, which reduces OM&A costs on a one for one basis.

In the bridge year, the underspend was due in part to the pension refund.

Moreover, the Settlement Agreement in EB-2014-0140 contained a provision which reduced the amount of OM&A by $20 million from $452.4 and $457.4 to $431.4 and $437 million in 2015 and 2016, respectively. HONI's evidence was that it was able to complete its planned maintenance and related programs within the revised budget.

There are other indications that HONI's OM&A is elevated relative to other utilities. Navigant stated that HONI's OM&A per station was at the high end of comparables, and that corrective maintenance was at a higher percentage of total maintenance than it should be, and recommended a ceiling on corrective maintenance, as a percentage of total maintenance.

BOMA is also concerned with the significant capex and in-service adds overages (capex in excess of the capex and in service adds forecast and approved for the year), in service in 2016[2], and the ensuing impact on the test years' revenue requirement.

That overage arises from the utility simply spending capital up to the limit of its execution capacity, regardless of the amount approved, together with the fact that there are unforeseen but urgent requirements to spend capital in most years, due to failures, projects for which an urgent need has developed, either through IESO directives, or opportunities to expand the scope of a project to complete ancillary work (Tr 9, p35).

As a result of these circumstances, you have assets put into service (rate base) and depreciation much higher than approved in the Board's decision (Settlement Agreement).

And while ratepayers obtained the protection of a variance account for underspend, in EB-2014-0140, there is no current protection from overspend.

That leaves ratepayers facing a significant rate increase in the test year reflecting excess assets that were completed, but not placed in-service in the bridge year, plus the assets in the investment plan for the test year that are placed in-service in the test year, plus the unanticipated needs that will arise in the test year. The expenditures that were made to meet unexpected needs, and other opportunity driven capex do face a prudency review, but if they were effectively non-discretionary, that issue is moot.

BOMA proposes that in recognition of the fact that there will always be some unanticipated capex requirement in an infrastructure as large as that of HONI Transmission, the approved

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[2]In 2016, the Board approved capex was $673 million. The actual was $911 million (Tr 9, p35).

capex and in service, adds should be reduced by $50 million each year (the average unforecasted capital expenditure or "emergency needs" in the last three years) to accommodate those expected requirements. In the event that need does not emerge in a particular year, the ratepayers would not be disadvantaged, since the $50 million would not be in rates; in other words, it is not a placeholder, it is a reduction of what would otherwise have been applied for. Based on the conclusion of the Risk Management Group's internal annual conference (BOMA I-3-10), the Company would probably benefit from increased productivity due to relief from pressure to execute unexpectedly large volumes of work.

As for the current list of emerging needs, BOMA suggests that, while the $20 million conductor repair program appears to be simply an acceleration of an existing program, that given the condition of the conductor, the need for repairs in any event before long, the Board should allow it into rate base, or not require that it be removed from rate base.

It is clear from the risk management discussion (Ibid) that the execution group executives and senior professionals were concerned about the rush to complete projects by year end, the refusal of planning and other senior management to relax in-service date that were unrealistic, the pressure to implement very large numbers of projects with limited resources, the need for more "front end" engineering work, and the lack of coordination of outage planning, project planning, and execution capabilities throughout the organization, and the need to improve estimating practices. In fairness, the Company has acted to review and improve the estimating process.

These discussions revealed that the risks associated with the above concerns were material and needed to be mitigated, and some programs were launched, which is positive. In addition, HONI recognized that it is not very experienced in managing third party construction contracts, and efforts are underway to experiment with different contract forms and procedures.

That said, the positive discussions of the group did reflect an unease with the project volume, size, and cost, that they were being asked to execute. In our view, this concern is another reason for the Board to exercise caution in addressing the proposed capital expenditures and rate base proposals for 2017 and 2018. The amounts should, at this time, not be materially increased beyond current levels, until all of these productivity initiatives are completed and HONI can demonstrate some tangible improvements in productivity and reliability, it would be imprudent to allow material increases in capital expenditures.

In the risk management conference, several comments were made to the effect that productivity is being sacrificed (5% to 10%) due to rushing to complete projects and get them in service, that safety is or could be compromised in the rush, that in service dates should be adjustable, and be adjusted, where appropriate.

Several comments were made to the effect that productivity is being sacrificed to the extent of 5% due to the rush to complete and get them in-service that safety could be compromised, and that in-service dates should be adjustable, and be adjusted where appropriate.

Overearning

The Company's evidence (BOMA 3-30) is that it overearned in 2012, 2013, 2014, and 2015, by the following amounts:

	2012	2013	2014	2015
Allowed ROE	9.42%	8.93%	9.36%	9.3%
Actual	12.41%	13.22%	13.2%	10.93%
Variance	2.99%	4.29%	3.76%	1.63%

Overearning is projected to be 2.6% in 2016. The four years were all years where a two year cost of service plan was in effect. These are very substantial overearnings in a cost of service regime.

The Company also noted, in response to a question from Mr. Thompson, that 100 basis points change in the return on common equity alters revenue requirement by approximately $57.4 million in 2017, comprised of a $42.2 million change in the return on equity and $15.2 million of associated income taxes (J12.4).

Over the four year period, overearnings were approximately $161 million (subject to adjustment for the lower income before tax in each of the years relative to net income in 2017).

So, if we took the average overearning of 3.16%, over the four year period, and assume that level of earnings under proposed rates in 2017, the shareholders would earn an additional $42 million plus in profit, relative to the amount it would have earned if it had earned its allowed return, none of it subject to earnings sharing.

The Company's explanation for the overearning included the fact of the warmer than normal weather in all four years, an income tax refund of about $40 million in 2013, and insurance proceeds payment of $10 million in 2014 in connection with the flood at Richview and Manby stations.

The Company provided a breakdown (J12.3) of the causes of the overearnings for 2012, 2013, 2014, but not 2015 or 2016, which showed weather as a residual item, accounting for about half the overearnings other items being the rebates, and overestimating capex, OM&A, and in-service dates. The Company did not provide an analysis of impact of weather by normalization or otherwise. It needs to do that and to use weather normalized data, as do the gas companies, so that it can demonstrate by a degree day calculation, the contribution of weather to over or underearning in each year. That said, the remaining amounts show a pattern of very aggressive forecasting, which under two year cost of service plans, is a recipe for higher than allowed earnings, in particular, where there is no earnings sharing.

The Company took both the property tax refund and the insurance proceeds as credits against the OM&A budget for 2013 and 2014 (Tr 12, pp56-57). The refunds and proceeds were not included in rates for those two years, so the amounts increased HONI's earnings. There were no variance or true-up accounts dealing with OM&A in those years or more recently, for that matter. In BOMA's view, the windfall should have been returned to the ratepayers, who had presumably already paid the higher tax amount in previous year rates. BOMA also applies the same logic to the disposition by HONI of 2014, it received a $10 million insurance payment related to the flood damage at its Granby and Richview stations. Again, the amount was allocated to the shareholders, notwithstanding that ratepayers had paid the premiums. The financial panel was unable to speak to these matters. The controller was not part of the panel.

Moreover, BOMA is of the view that HONI has systematically overforecast its OM&A for the last several years. The average overestimate was $24.5 million over the years 2012, 2013, 2014, and 2015. Since there is no true-up for OM&A and the cost of service regime is two years, rather than one year, there were no adjustments to those numbers, and one dollar in increased operating profit equals one dollar in revenue requirement, and about 74 cents in net income. The revenue requirement would have increased by that amount in each of those years. BOMA is of the view that the overforecasting of OM&A likely applies to the test year as well, by a comparable amount. The systematic overforecasting provides the opportunity for the Company to say, once the actuals came in, that it operated more efficiently, without having to discuss in detail how it achieved these efficiencies. For example, the Company did not offer any evidence as to how it achieved the numerous reductions in line items each year in I-13-25. In BOMA's view, the reductions were as much or more due to aggressive forecasting than realized efficiencies in operations. The overforecasting led to an increase of about $18 million in tax earnings. In 2017, it would produce an overearn of about forty basis points, all on its own.

Productivity Initiatives

The Company's evidence is that TCJ1.17 outlines the productivity savings that are included in the Application (Tr 1, p20).

The more detailed explanation by Mr. Bowness is that it has initiated a number of measures having to do with project execution, which would increase productivity. These measures cover the following components and percentages of the project implementation budget – materials (30%), construction labour, fleet and equipment contracts (20%), construction contracts (15%), engineering and project management (15%), and interest on overhead (15%). The numbers in brackets represent that activity's percentage of share of the annual capital work program (Exhibit B1, Tab 4, Schedule 1, p2).

BOMA agrees with the Company's assertion that the estimating initiative, discussed above, should result in more cost effective project delivery over time. It may not reduce the cost of the materials, in fact, more accurate estimating may actually increase the cost of the project, or the project labour per sé, but should reduce the cost of executing the project, by reducing time spent by HONI's engineers, managers, technicians, and trades, on the project. It will likely take some years for the changes to take hold and realize those savings. HONI needs to monitor and measure these savings. It may require less internal personnel to execute the same size work plan. HONI could not offer an estimate of savings (Tr 9, p63). In the RRFE, the Board has emphasized the need to seek continuous improvements over the long term, and monitoring and measuring the resulting year over year savings is essential, see, for example, pp (i) and (iv) of EB-2010-0379, Report of the Board, Measurement for Electricity Distributors: A Scorecard Approach.

HONI is also beginning to experiment with different construction contract models, other than its traditional fixed price model, which may lead to project cost savings when outsourcing construction on an EPC basis or otherwise. Again, the savings should be measured over time and it will take some time to emerge. They will not likely be evident during 2017; perhaps in 2018. The Company estimates savings in the 2% to 5% range on construction contracts, and indicates that it is likely to increase the use of third party construction contracts. BOMA would note that moving from fixed price to a more cost-plus-like arrangement does shift some risk for the contractor to HONI, although that can be offset to some degree by the reduction of the contractor's "fixed price premium" in its bid.

HONI proposes several measures to improve procurement savings, which are listed at TCJ1.17, pp1-5.

While recognizing HONI's efforts to generate OM&A and capital savings, BOMA has some concerns.

First, the procurement and IT savings (the two areas of identified savings initiative) are described as being already embedded in the investment plan for the test year.

The problem with that approach is that it is difficult to measure and validate the amount of the savings relative to the existing expenditures on specific measures, and as the savings are not separately identified, it is impossible to verify their existence, and to verify the cost benefit analysis that justified that measure.

The Board has also noted, in recent decisions, that it is not enough to embed the savings in the overall investment plan and OM&A budget. The savings from each measure should be identified and analyzed on an individual, or at least a category basis.

The second concern is that the proposed procurement measures cover the full range of the products and services the Company acquires. They then contain all or most of the following:

- Use RFPs in all cases, and broaden the scope of the RFPs to include more parties.
- Use competitive negotiation with leading bidders.
- Get greater contractor transparency to negotiate margins and premiums down.
- Renegotiate professional services contracts of all types at lower rates.
- Bundle like and complementary services under one RFP/contract to get volume discounts/consolidate supplies to get volume discounts.

These are all worthy initiates, but they appear to be in their early stages of implementation. It is unlikely the estimated savings will be achieved in 2017.

The estimated savings for the measures are almost all in the 5% to 15% range, but the base amount is not always detailed. They smack of "back-of-the-envelope" assessments.

For greater clarity, transparency, and to allow the Board and others to monitor and verify the amount of the savings:

- HONI needs to establish the current budget for each activity where new measures to produce future savings are being claimed, the forecast dollar value of realizing the initiative in whole or in part, and a timetable.
- Report on progress in meeting the proposed savings reduction and include some savings targets in the scorecard. It should provide a status report by December 31, 2017, and, if required, an amendment to the proposed savings measures for 2018, a mid-term correction.
- These changes are required to impute meaning to the idea of continuous improvement over time and eventual comparability, which are an important part of the RRFE.
- HONI states that it capitalizes costs that are directly applicable to capital projects (as well as overhead costs to support capital projects). It is not clear what percentage of costs that would otherwise be OM&A costs, eg. engineering, project management, drafting/design, are capitalized over time and how that varies from one year to the next. What is important is the degree to which the capitalization of what would otherwise be OM&A costs reduce those costs each year. While there has been discussion of capitalization rates, including overhead capitalization rates, there has not been the same level of

scrutiny of capitalization of project costs generally, including what costs are included within the pools eligible for capitalization, what changes have taken place over the nature of the costs included in the past, and how much discretion one company has, and how it exercises that discretion to include or exclude costs. How close may the link be, both when they are performed by third parties, under various EPC contracts, or by HONI's own personnel. HONI should address this matter in its next case.

Issue 12

Are the metrics in the proposed scorecard appropriate and do they adequately reflect outcomes? Do the outcomes adequately reflect customer expectations?

The Company's evidence is that the team scorecard, that is to say, the scorecard used to drive executive compensation, is not the scorecard contained in its evidence at Exhibit B2, Tab 1, Schedule 1 (Attachments 1 and 2). Nor is not the one provided in the evidence at Exhibit I, Tab 6, Schedule 4, pp2 and 3. Rather, it is the scorecard included in the Presentation Day slides at p34.

The Proposed Transmission Regulatory Scorecard (Exhibit B2, Tab 1, Schedule 1, p5 of 23), entitled Proposed Transmission Scorecard. Finally, there is a "2017 Team Scorecard" (J1.02, Attachment 1, p1). There are also other scorecards. The evidence on scorecards is somewhat confused.

In BOMA's view, any scorecard that the Board approves should link directly to executives' discretionary pay, in order to ensure for results accountability.

In other words, the scorecard that the Company uses to drive the variable compensation of its executive team is different from the scorecard that the Company intends to file with the Board every April, the contents of which are set out in EB-2010-0379. The Board designed a scorecard to achieve the Board's specified outcomes, and it employs metrics which measure progress towards achieving those outcomes over time. While there are common features between the scorecards, for example, a focus on safety, they are otherwise very different. The Company's scorecard which drives compensation contains no reference to system reliability, asset management, cost control, public policy responsiveness. Moreover, the largest single component (40%) in the Company's Team scorecard is financial performance, as measured by net income. Given the nature of utility profits, net income is highly dependent on growth in rate base. There is a disconnect between the metrics designed to achieve the Board's expected outcomes and the scorecard which the Company will use to determine 80% of the executives' total compensation, and 50% of the compensation of a very large number of managers. BOMA appreciates that the Company will use other, more detailed KPIs to determine the compensation of individual executives, but the individual portion of the compensation is much smaller than the team driven portion. However, BOMA's concern is that while the Company will dutifully report to the Board on the metrics in the Board scorecard, the real driver for its activities will be its own team scorecard. The results may well vary from those that the Board deems to be the most desirable, and even may not be in the public interest. The Board should, therefore, not approve the team scorecard. It should require that the Company file the Board's 2016 scorecard by April 1, 2017. The Company should also be directed to file its annual customer satisfaction survey(s), which will also be used to guide compensation and to provide more detail on the commitments made to customers. In other words, the Board should oversee the integrity of the implementation of the team scorecard. The Board should address the disconnect between the two scorecards.

BOMA believes the scorecards should be assessed from the point of view of are they reasonable, taking into account expressed shareholders' preferences, system needs, and other desirable outcomes, and are they appropriately linked to executive compensation. Otherwise, the desired improvements will not happen.

The Company's evidence was:

> "The format of this scorecard [the Board's scorecard] is one that was in place previously, but not the all of the metrics that are here are included in our team scorecard that drives the overall compensation for the company. Each of our executives and individuals throughout the company will have subsidiary KPIs, in addition to the team scorecard." (Ibid, p80)

Higher net income will, in the normal course, lead to higher earnings per share, will drive higher share prices, which will benefit the holders of the 39% of Hydro One's shares in private investors' lands, and the Ontario government which continues to own 61% of the stake. Higher net income will also drive higher dividends. However, the Company's evidence in respect of its financial objective is somewhat unclear. Mr. Reid stated that the Company's objective was to earn its allowed rate of return. However, Mr. Vels stated that if the Company can increase its return on equity above its allowed return (as it has done very successfully over the last four years (2012 to 2015), and in 2016 as well), the management should "share in that through higher compensation".

At the moment, HONI not only shares in the savings achieved by any efficiencies, and its management takes all of the benefit in the form of a higher return, there is no deferral account associated with overearning, and no earnings savings sharing to ensure that ratepayers also share in efficiency or other gains.

In BOMA's view, whether under cost of service, or custom IR, earning sharing for earning exceeding the allowed rate of return is necessary to ensure just and reasonable rates, and to align utility and ratepayer interests, a fundamental principle of the Renewed Regulatory Framework Policy. The earnings should be shared 50%/50%, with no deadband. Earnings sharing is essential to secure the desired alignment, given the necessary focus of the Company as an investor-owned corporation in seeking to maximize its profitability.

With earnings sharing in place, both shareholders and ratepayers will benefit if HONI executives and managers are strongly incented by the 2017 team scorecard to grow net income actually do so. Ratepayers' interests will be aligned with the Company. Otherwise, ratepayers will be harmed by earnings above the allowed rate of return, and the interests of ratepayers and shareholders will diverge. The rate of return allowed HONI by the OEB is the rate that the Board perceives be fair for a regulated monopoly, providing an essential service, electricity transmission, operating in a cost of service regime, or a custom IR regime. That rate is no less appropriate if the Company acquires new, non-governmental shareholders witness the experience of the natural gas utilities. The Board need not oppose a scorecard or compensation system designed to incent return in excess of the allowed rate, if earnings sharing is in place. Net income is a metric which will increase if rate base increases, new markets or larger markets, are formed or developed, or efficiencies and other productivity gains are achieved. Both the Company and the ratepayers should benefit from gains in net income.

Some of the metrics in the team scorecard clearly need to be refined. The Company agreed that the scorecard metric in-service additions as a percentage of budgeted in-service additions, on its own, does not incent the Company to spend capital as efficiently as possible (Tr 2, p30). And the Company did not provide, as part of its scorecard, how second or third tier metrics work in concert with that scorecard metric to achieve the desired result. Moreover, the execution risk panel members were concerned that the push to meet in-service budgets and the management's reluctance to change in-service dates would be safety risks and would lead to loss of efficiency, especially if the in-service target is overly aggressive. So, there can be conflict between overly aggressive capital expenditures, budgets, and in-service date targets, efficiency and productivity. HONI has not explained why unit costs are not yet a part of its team scorecard, given the importance the Board accords cost control in the RRFE.

Moreover, the Company does not employ unit cost metrics in the evaluation of its pole replacement, or steel tower coatings programs. The Company stated that they are working on introducing unit cost as a metric into the pole replacement program, but they are not there yet (Tr 1, p33). And it is not clear whether the unit cost metrics for various asset replacement and enhancement projects will be in the team scorecard or the individual scorecard. Before long, HONI needs to introduce targets into its team scorecard.

Line Losses

BOMA requests that the Board direct Hydro One to develop a Transmission Loss Reduction Plan to identify all cost-effective loss reduction measures over the next six months, and to implement all cost-effective loss reduction measures, defined as loss reduction measures that would reduce bills because $1.00 invested would save consumers over $1.00 in avoided costs. HONI should report on progress in its next rate case.

Transmission losses cost Ontario energy consumers several hundred million dollars in 2015, according to recent estimates (IESO).

Second, losses are "paid" ultimately by end user customers of all types, via the Global Adjustment.

Third, as the Board is well aware, the IESO has stated that transmission and distribution losses are conservation measures and, as such, their reduction falls under the government's Conservation First initiative.

To date, the IESO and Hydro One have never calculated a reasonably precise number for the amount of annual losses.

The Company's evidence is that Hydro One, not the IESO, is responsible for selecting the size and materials for conductors. Failure to address losses when making equipment decisions in the next few years would lock in inefficiencies for the next fifty to eighty years.

BOMA believes that Hydro One has not done the analysis necessary to establish whether additional steps should be taken to reduce losses and some customers' money, notwithstanding that it seems that many other large utilities have done such analyses and made them publicly available., or if it has, has not provided such evidence in this proceeding.

BOMA had the opportunity to review Environmental Defence's argument since it was filed in midday on February 1, 2017. BOMA agrees with much of the submission, including the analogy to a highway building trying to allow for faster moving traffic. "Wider roads allow for faster travel, like bigger conductors allow for more efficiency transmission".

Impact of CDM on the Load Forecasts

In BOMA's view, the Board cannot rely on any of the adjustments of HONI's load forecasts that relate to CDM measures, codes and standards. The exchange between Mr. Janigan and HONI during his cross-examination (Tr 12, p138, et seq) revealed deficiencies that undermine HONI's use of the data. Deficiencies include:

- witnesses not even recognizing their own evidence;
- confusion in the testimony between forecasts and actuals;
- confusion in the testing about forecasts, actuals, projections and targets;
- confusion in the testimony about sources of data;
- confusion in the testimony about timing of data production;
- exclusion of adjustment on peak demand just because the IESO targets no longer include demand savings;
- lack of verifiable sources for the impacts on energy/demand of improvements to codes and standards;
- IESO accepting its forecasts of the impacts of codes and standards to be the actuals, and HONI's acceptance of this acceptance.

The Board cannot rely on this data in the same way that it uses, and relies upon, the verified and audited results of natural gas DSM in the natural gas hearings.

First Nations

BOMA adopts all of the comments of Board staff, with respect to the issues raised by First Nations.

In addition, BOMA suggests that HONI working with IESO, develop a plan to increase the reliability of services to Northern Ontario, including all First Nations communities.

All of which is respectfully submitted, this 6th day of February, 2017.

Tom Brett,
Counsel for BOMA

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APPENDIX A

The Estimates Committee reviewed the MOEE's estimates in proceedings on September 29, 2015, October 7, 2015, October 20, 2015, and October 21, 2015.

The discussion of the departure tax, and on related matters, was touched on at different points over the period. The most pertinent pages are excerpted, in the following pages of this Appendix.

The transcripts of the Estimates Committee proceeding can be found in Official Report of Debates (Hansard), Legislative Assembly of Ontario, First Session, 41st Parliament.

from tax revenue, it's not coming from cutting services, it's not coming from debt—

Mr. Todd Smith: It's coming from selling the golden goose, is where it's coming from. You are selling the golden goose.

Hon. Bob Chiarelli: The reality is, there are going to be a number of solutions that will be put in place for infrastructure funding. We have always said that the proceeds from Hydro One are part of a solution. They go into a Trillium fund for infrastructure and it will be spent on infrastructure. There is other funding that is being realized from other assets as well. Selling assets is not the only solution. Part of the solution is running good government.

Mr. Todd Smith: Well, that would be nice. It's been a long time since we've had good government in this province—12 years, as a matter of fact, since we've had good government.

I'll end on that note. Thank you, Minister.

The Chair (Ms. Cheri DiNovo): Thank you, Mr. Smith. We now go to the—

Mr. Chris Ballard: We've got a comedy routine

The Chair (Ms. Cheri DiNovo): Quiet, please. We now go to the third party.

Mr. Peter Tabuns: Thank you, Chair. Good morning, Minister, Ms. Geraghty, Mr. Imbrogno.

I want to start off with the supplementary estimates that came out last week. There is an expenditure of $2.663 billion for assets management and transformation. It shows a cost of $2.6 billion for tax adjustment offset. What is this meant to pay for?

Hon. Bob Chiarelli: It's part of the transitioning, the transactions that have to take place in creating a new Hydro One as a public company. We do have the numbers and the deputy will explain what those are.

Mr. Serge Imbrogno: Mr. Tabuns, the $2.6 billion represents the capital contribution that the province is making to Hydro One. It's related to the departure tax that Hydro One pays.

Mr. Peter Tabuns: I want to just get into that a bit further. This is a $2.6-billion contribution from the province to Hydro One?

Mr. Serge Imbrogno: That is correct.

Mr. Peter Tabuns: So it's coming out of our treasury?

Mr. Serge Imbrogno: Well, it's fiscally neutral because when Hydro One leaves the PILs regime under the Income Tax Act, it makes a departure tax payment, like any other corporation would. That's a $2.6-billion payment to the province. To keep Hydro One whole, there is a $2.6-billion payment back to Hydro One to maintain its capital so it can optimize its valuation going forward.

Mr. Peter Tabuns: Just a second. You're telling me the $2.6 billion comes from our treasury, goes into Hydro One, Hydro One writes a cheque back to the government of Ontario for taxes—

Hon. Bob Chiarelli: The other way around.

Mr. Peter Tabuns: Pardon?

Hon. Bob Chiarelli: Hydro One, as an LDC, is required to pay the tax. We're paying a tax to ourselves. Our entity is paying $2.6 billion to ourselves, the treasury. It's going from one bank account that we have to another one, and we're putting it back in. So it's revenue-neutral.

Mr. Peter Tabuns: Let's just get the names of those accounts. The $2.6 billion is coming from the treasury—

Hon. Bob Chiarelli: No.

Mr. Serge Imbrogno: The $2.6 billion is paid from Hydro One into the Ontario Electricity Financial Corp.—

Mr. Peter Tabuns: Ah, it goes to the OEFC. Okay.

Mr. Serge Imbrogno: That's correct. We consolidate the OEFC so that $2.6 billion then comes back onto the province's books. So that's fiscally neutral. Then there's another transaction where the province then makes a payment, a capital contribution, into Hydro One. We have assets in Hydro One as a set-off to that. So both those transactions are fiscally neutral to the province, and we're doing that to maintain a capital structure that, I guess, optimizes our proceeds going forward.

Mr. Peter Tabuns: So the $2.6 billion is going to reduce the debts that OEFC is liable for?

Mr. Serge Imbrogno: That's correct.

Mr. Peter Tabuns: So is this part of the $5-billion debt reduction that's supposed to come out of this deal?

Mr. Serge Imbrogno: No. This is different. This is like any corporation that leaves the tax regime—that goes from the payments-in-lieu regime to income taxable under the federal Income Tax Act. There's a departure tax that's paid. Any PIL payment goes to the OEFC—

Mr. Peter Tabuns: And why is it that Hydro One is not paying this out of the revenues it receives from the sale?

Mr. Serge Imbrogno: The tax is due before you actually go into the IPO. It's the second before, technically.

Mr. Peter Tabuns: So where is the government of Ontario getting the $2.6 billion that's used to pay OEFC ultimately?

Hon. Bob Chiarelli: From Hydro One.

Mr. Serge Imbrogno: Hydro One is making that payment into the Ontario Electricity Financial Corp.

Mr. Peter Tabuns: The government of Ontario gives money to Hydro One; Hydro One gives the money to OEFC.

Mr. Serge Imbrogno: No; sorry. Let's just start from the first part of it: Hydro One is required to pay the departure tax. So Hydro One pays the $2.6 billion into the Ontario Electricity Financial Corp.

Mr. Peter Tabuns: Fair enough. So the new investors start off with $2.6 billion they've paid out.

Mr. Serge Imbrogno: Right. And those—

Mr. Peter Tabuns: So why are we giving them $2.6 billion?

Mr. Serge Imbrogno: Let me just finish that. That payment—the tax and the payment—is neutral because we consolidate Hydro One. So they're down $2.6 billion.

but we consolidate OEFC so it's up $2.6 billion, so those two are fiscally neutral.

Mr. Peter Tabuns: I think I may come back to you on this question again.

There's a $63-million cost that's in here for services. What's that $63 million for services?

Mr. Serge Imbrogno: It would include the total fees that we estimate for the syndicate for selling the shares of Hydro One. It would include the ministry legal support services from outside advisers. It would include other costs related to some financial firms that support the ministry in the transaction. They're all one-time costs related to supporting the IPO.

Mr. Peter Tabuns: We've put out $63 million, and it comes through your accounts, Minister. Does Hydro One reimburse the province of Ontario for the $63 million?

Hon. Bob Chiarelli: It comes out of the proceeds of the IPO. In other words, it comes out of the proceeds of selling the shares.

Mr. Peter Tabuns: So it reduces the $9 billion we're targeting by $63 million?

Hon. Bob Chiarelli: The $63 million in services for the IPO listed in the supplementary estimates will be fully recovered through the proceeds from the IPO. The bulk of this cost is $50 million for underwriting and book runner fees. Just a week or two ago, the Globe and Mail noted that our government has persuaded Bay Street to accept some of the lowest IPO underwriting fees imaginable. I think you're aware of those comments. The remainder was spent on corporate legal advisory services, negotiated agreements and advisory services for future offerings. We're doing it in tranches, presumably one quarter, one quarter, one quarter, one quarter, and these costs, again, will be fully recovered from the proceeds of the IPO.

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Mr. Peter Tabuns: So if it's $63 million—

Hon. Bob Chiarelli: You could not do an IPO without incurring these costs.

Mr. Peter Tabuns: I understand that. So, four tranches, four times $63 million—over $240 million—

Hon. Bob Chiarelli: No, the other tranches are included in the $63 million.

Mr. Peter Tabuns: So $63 million is the cost for the whole $9 billion sale. Is that correct?

Hon. Bob Chiarelli: Whatever the number happens to be.

Mr. Peter Tabuns: The targets we've heard all along are $4 billion for infrastructure, $5 billion for debt reduction. Is there another number that I should be aware of? Is that a guess, or is that what we expect to—

Hon. Bob Chiarelli: Those are the best estimates that went into the prospectus.

Mr. Peter Tabuns: So they could be very different.

Hon. Bob Chiarelli: It's a market. They could be much higher—

Mr. Peter Tabuns: Or they could be much lower.

Hon. Bob Chiarelli: —and so in the wisdom of the people who were doing the financial investment management, they are taking a very conservative outlook of how to proceed.

Mr. Peter Tabuns: So $63 million—that reduces the amount of money that comes back to the province to reduce debt and pay for infrastructure. Is that correct?

Hon. Bob Chiarelli: It comes out of the proceeds—

Mr. Peter Tabuns: Mr. Imbrogno is nodding, but—

Mr. Serge Imbrogno: Yes, it would be from the proceeds, so it would reduce proceeds.

Mr. Peter Tabuns: Right. So $9 billion less $63 million.

Mr. Serge Imbrogno: I'm hesitating on the $9 billion.

Mr. Peter Tabuns: You've got to pay lawyers somehow.

Mr. Serge Imbrogno: Whatever the number is, when we actually do the final sale.

Mr. Peter Tabuns: I'm sorry, repeat that?

Mr. Serge Imbrogno: I'm not speculating on the $9 billion. I'm just saying when we go to market, there will be a price, and the proceeds will be from that.

Mr. Peter Tabuns: Okay. Just one second. In your estimates strategy section, you talk about upgrading the transmission system. Can you tell us what major upgrades Hydro One expects to put in place?

The Chair (Ms. Cheri DiNovo): This is a three-minute warning.

Hon. Bob Chiarelli: Okay. Sorry, where are you looking in the estimates?

Mr. Peter Tabuns: Look at page 7: Strategies: Continue to transition to a modern and reliable energy system by upgrading our transmission and distribution systems.

Can you tell me where you're planning to invest in the transmission system?

Hon. Bob Chiarelli: There are a whole range of transmission issues that are part of the long-term energy plan. But let me make it very, very clear: When we amended the Electricity Act, we and the OEB, we gave ultimate decision-making authority with respect to new transmission and transmission changes to cabinet. Hydro One has nothing to do with that particular issue.

That includes, for example, the northwest transmission Pickle Lake line, for which, about three or four weeks ago, we announced a wonderful public-private partnership between 20 First Nations communities and two private sector companies. We, through the IESO and through our regulatory process, are authorizing that to go ahead. It's specifically mentioned in the long-term energy plan, and we're implementing that. That brings the grid to remote communities.

Mr. Peter Tabuns: Can I go back to an earlier part of your statement? Have you—

The Chair (Ms. Cheri DiNovo): We have only a few seconds left. Perhaps we can wrap it up there, and I'll do this—

Mr. Peter Tabuns: It was a great question, Chair.

The Chair (Ms. Cheri DiNovo): —and we will reconvene this afternoon after routine proceedings. Thank you, everyone.

The committee recessed from 1014 to 1545.