TORYS LLP

79 Wellington St. W., 30th Floor
Box 270, TD South Tower
Toronto, Ontario M5K 1N2 Canada
P. 416.865.0040 | F. 416.865.7380
www.torys.com

July 14, 2017

RESS, EMAIL & COURIER

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

Attention: Ms. K. Walli, Board Secretary

Dear Ms. Walli:

Re: Hydro One Sault Ste. Marie LP - Application for 2017 Transmission Rates (EB-2016-0356) – Applicant Reply Submissions

We are counsel to Hydro One Sault Ste. Marie LP, applicant in the above-noted proceeding. Please find enclosed the applicant's Reply Submissions, which have been filed on RESS and sent to the Board in hard copy.

Yours truly,

Tyson Dyck

Tel 416.865.8136
Fax 416.865.7380
tdyck@torys.com

Enclosure

cc: Intervenors
Mr. A. Parcels, *Hydro One SSM*
Mr. K. Lewis, *Hydro One SSM*
Mr. C. Keizer, *Torys LLP*

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O.1998, c.15 (Sched. B)

AND IN THE MATTER OF an application by Hydro One Sault Ste. Marie Inc. on behalf of Hydro One Sault Ste. Marie LP for an Order or Orders pursuant to section 78 of the *Ontario Energy Board Act, 1998* for 2017 transmission rates and related matters

EB-2016-0356

Applicant Reply Submissions

Hydro One Sault Ste. Marie Inc.

on behalf of Hydro One Sault Ste. Marie LP

July 14, 2017

1.0 Introduction

1. These are the reply submissions of Hydro One Sault Ste. Marie LP ("Hydro One SSM" or the "Applicant") to the submissions of Association of Major Power Consumers of Ontario ("AMPCO"), Schools Energy Coalition ("SEC"), Vulnerable Energy Consumers Coalition ("VECC") and Board Staff (together, the "Parties").

2. The arguments put forward by the Parties in their responding submissions raised a number of issues. This reply is organized so as to address each of those issues, which relate to the following aspects of the Application:

   - The requested effective date of January 1, 2017;
   - The proposed revenue cap annual adjustment, including the inflation factor, productivity factor, and stretch factor;
   - The request to disburse or continue certain deferral and variance accounts; and
   - The Applicant's plans with respect to performance reporting and monitoring as well as the development of an asset management plan ("AMP").

2.0 Revenue Requirement Effective Date

3. Hydro One SSM requests that the proposed revenue requirement be made effective January 1, 2017. For the 2017 test year, if implementation of approved rates occurs after January 1, 2017, Hydro One SSM requests that the existing transmission rates be made interim to permit the implementation of the proposed revenue requirement effective January 1, 2017, and that an accounting order be approved to establish a sub-account within deferral account 1574 to record revenue deficiencies incurred from January 1, 2017 until Hydro One SSM's proposed 2017 revenue requirement and rates are implemented.

<u>Submissions of the Parties</u>

4. Board Staff has no concerns with the requested effective date, noting that the Application constitutes relatively prompt attention to the Board's Decision and Order in Hydro One

Inc.'s ("HOI") application for the acquisition of Great Lakes Power Transmission Inc. (EB-2016-0050)[1].

5. SEC submits that Hydro One SSM's revenue requirement effective date should be set as the date a final decision is rendered in this proceeding, and that the Board should only approve a deferral account to capture foregone revenue from the date of the Board's decision in this proceeding and the setting of any final 2017 Uniform Transmission Rates ("UTR").[2]

6. VECC submits that unless the Board issues an order declaring the 2017 UTR (as they relate to Hydro One SSM) interim prior to its decision, the effective date should be the same as the implementation date. In VECC's view, due to the rule against retroactive ratemaking, the earliest possible effective date should be July 1, 2017.[3]

Applicant's Reply

7. The Applicant submits that the circumstances in this case warrant the establishment of a January 1, 2017 effective date. The MAAD application in EB-2016-0050 was filed on March 10, 2016, and the Board's decision (the "MAAD Decision") was issued on October 13, 2016. HOI's purchase of Great Lakes Transmission then closed on October 31, 2016. On the basis of the MAAD Decision and the closing of the transaction, Hydro One SSM promptly began the process of preparing the Application, which it filed as soon as practicable – less than two months – after the acquisition by HOI closed. As noted by Board Staff, the form of this Application is the result of the MAAD Decision, and the December 23, 2016 filing date of the Application constitutes prompt attention to the MAAD Decision, particularly given that the Application had to be prepared and filed under new ownership.[4]

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[1] Board Staff Submissions, p. 3.

[2] SEC Submissions, p. 4.

[3] VECC Submissions, pp. 9-11.

[4] Board Staff Submissions, p. 3.

8. Further, SEC and VECC fail to recognize in their submissions that the Applicant had filed a cost of service application on August 26, 2016, which was in and around the same timeframe as the filing of its previous revenue requirement applications (i.e. July 14, 2014 in EB-2014-0238, and June 29, 2012 in EB-2012-0300). As a result of the MAAD Decision, that earlier cost of service application had to be withdrawn, and the current Application was filed shortly afterwards. The timing and impact of the MAAD Decision, namely the withdrawal of the cost of service application, was beyond the control of Hydro One SSM.

9. Lastly, the Applicant disagrees with VECC's argument relating to interim rates and retroactivity. In the EB-2016-0160 hearing regarding Hydro One Networks Inc.'s ("Hydro One Transmission") revenue requirement application for 2017-2018, the 2016 UTRs currently in place were declared interim until the 2017 UTRs are in place[5]; this was further confirmed by the Board's EB-2016-0349 Decision and Order regarding B2M LP's 2017 transmission revenue requirement.[6] Given that the UTR is based on the combined revenue requirements of Ontario transmitters, it is reasonable to assume that this would apply to Hydro One SSM as well. The Board's typical approach has been to establish deferral accounts to permit eventual recovery of the difference between the revenue requirements as reflected in the UTR and those approved by the Board in deciding a transmitter's application. In this case, the fact that the Board has not declared the proposed revenue requirement interim does not prevent the establishment of the requested account. The Board is able to establish such an account at any time after the application has been made (including the effective date). As recognized by Board Staff, Hydro One SSM's request to establish the deferral account is reasonable and consistent with relevant precedents.[7] The law relating to interim rates and retroactive ratemaking does not apply since the actual transmission rates charged to customers will not be affected until some point in the future (i.e. likely after the decision and rate order regarding Hydro One Transmission's revenue requirement).

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[5] EB-2016-0160 Oral Hearing Transcript (November 24, 2016), p. 4, lines 12-13.

[6] EB-2016-0349 Decision and Order, p. 2.

[7] Board Staff Submissions, p. 5.

3.0 Inflation Factor

Submissions of the Parties

10. All Parties agree with, or have no objections to, the proposed inflation factor of 1.9% for 2017. Board Staff requests clarification regarding Hydro One SSM's plan to update the inflation factor.[8] In addition, Board Staff is of the view that the weighting of labour and non-labour inputs may differ between transmission and distribution, and suggests that Hydro One SSM should consider the appropriate weighting of inputs in its future revenue requirement applications.[9]

11. AMPCO agrees with Board Staff's view.[10] SEC is also in agreement, and suggests that information regarding a transmission-specific inflation factor should be provided in the 2018 application.[11] Similarly, VECC considers the proposed inflation factor reasonable as an interim approach, and submits that the transmission-specific rate adjustments to be outlined in Hydro One Transmission's 2019-2023 revenue requirement application ("2019 Revenue Requirement Application") should be applicable to Hydro One SSM, or that Hydro One SSM should otherwise bring its own transmission-specific proposals as part of its 2018 (or at the latest, 2019) revenue requirement application.[12]

Applicant's Reply

12. Until transmission-specific proposals for annual adjustments are available, Hydro One SSM believes it is reasonable to update the inflation factor on an annual basis using the Board's posted factor for distributors. However, if Board Staff's methodology were implemented for Hydro One SSM for 2017 and 2018 (i.e, prior to it adopting Hydro One Transmission's methodology that will be proposed in the 2019 Revenue Requirement Application), Hydro One SSM would not object.

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[8] Board Staff Submissions, p. 3.
[9] Board Staff Submissions, p. 8.
[10] AMPCO Submissions, p. 2.
[11] SEC Submissions, p. 1.
[12] VECC Submissions, p. 5.

13. Further, Hydro One SSM has reviewed the weighting of labour and non-labour inputs, using the methodology put forth by OPG in EB-2016-0152. The 5-year historical results are provided in the table below. Using this methodology would result in an increase to the proposed inflation factor from 1.9% to 2.0%.

	2012	2013	2014	2015	2016	5-year average
Labour	27%	42%	43%	31.8%	28.5%	34.5%
Non-Labour[13]	73%	58%	57%	68.2%	71.5%	65.5%

4.0 Productivity Factor

Submissions of the Parties

14. Board Staff is supportive of using a 0% productivity factor for 2017 and 2018, and submits that while a Total Factor Productivity ("TFP") study would be too onerous for Hydro One SSM to undertake on its own, Hydro One Transmission should complete such a study for its 2019 Revenue Requirement Application.[14] AMPCO and SEC each agrees that a 0% productivity factor is appropriate for 2017, and that a TFP study should be completed for Hydro One Transmission's 2019 application.[15] Similarly, VECC considers the proposed productivity factor reasonable as an interim approach, and submits that the transmission-specific rate adjustments to be outlined in Hydro One Transmission's 2019 Revenue Requirement Application should be applicable to Hydro One SSM, or that Hydro One SSM should otherwise bring its own transmission-specific proposals as part of its 2018 (or at the latest, 2019) revenue requirement application.[16]

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[13] Includes capitalized labour costs

[14] Board Staff Submissions, pp. 9-10.

[15] AMPCO Submissions, p. 2; SEC Submissions, p. 2.

[16] VECC Submissions, p. 5.

Applicant's Reply

15. Hydro One SSM's submits that Hydro One Transmission will be undertaking a TFP study in connection with its 2019 Revenue Requirement Application. The results of that TFP study are expected to be available to Hydro One SSM.

5.0 Stretch Factor

Submissions of the Parties

16. Board Staff and VECC each submits that Hydro One SSM's stretch factor for 2017 should be set at 0.3%.[17] AMPCO is of the view that a stretch factor of 0.45% is appropriate.[18] SEC believes 0.6% is appropriate.[19] In support of their respective argument on this issue, the Parties rely on certain interpretations of the First Quartile Consulting ("1QC") benchmarking report, and Board Staff also references examples of consolidation transactions in the distribution context. These arguments are addressed below.

Applicant's Reply

17. Hydro One SSM's proposed approach is consistent with Chapter 2 of the Filing Requirements in which the Board recognizes "that a transition period may better accommodate the gradual entrenchment of RRFE objectives and principles in transmission rate-setting over time. Therefore, where a transmitter is filing based on cost of service or the Revenue Cap index, if benchmarking evidence is not currently available, the transmitter must file in its application a strategy to acquire such evidence for its subsequent application."[20]

18. The Parties are generally of the view that the 1QC benchmarking results do not show top cohort performance to justify a 0% stretch factor. In fact, Hydro One SSM performs very well on a cost per asset basis. Although Hydro One SSM has not been asked to develop a

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[17] Board Staff Submissions, p. 12; VECC Submissions, pp. 8-9.

[18] AMPCO Submissions, p. 3.

[19] SEC Submissions, p. 2.

[20] *Filing Requirements for Electricity Transmission Applications*, Chapter 2 – Revenue Requirement Applications (February 11, 2016), p. 2.

stretch factor in previous years, and has not conducted all of the necessary studies to reach a fully valid conclusion, based on the information in the 1QC benchmarking report, Hydro One SSM shows consistently better than average performance (in the upper quartiles) for the comparison panel for O&M and for OM&A costs, and it is clear that its relative position is improving. Hydro One SSM plans to adopt the stretch factor that Hydro One Transmission will propose in its 2019 Revenue Requirement Application. Until that point, given the better than average performance of Hydro One SSM described in the 1QC study, it is Hydro One SSM's view that applying a stretch factor would not be reasonable.

19. In any event, although Hydro One SSM does not believe it is appropriate to apply any stretch factor to Hydro One SSM, the suggestions by SEC and AMPCO that stretch factors representative of the worst performers in the industry be applied to Hydro One SSM is unwarranted.[21] As SEC acknowledges, Hydro One SSM performs in the upper quartiles for O&M and OM&A costs, so even if the proposed methodology were in place for this rates proceeding, SEC's proposed stretch factor is unwarranted.

20. Secondly, AMPCO and SEC point to the fact that the 1QC benchmarking accounted for Hydro One SSM's OM&A costs only.[22] Hydro One Transmission's benchmarking study, to be filed in 2018 for its 2019 Revenue Requirement Application, will include both capital and OM&A spending. As indicated previously, the intention is to apply the same stretch factor to Hydro One SSM as that of Hydro One Transmission.

21. Thirdly, AMPCO and SEC argue that the peer group for the 1QC study was inadequate.[23] Hydro One SSM notes that the same peer group has been used for the past several rates proceedings for Great Lakes Power Transmission Inc. Although the peer group is a relatively small group, it is representative of the industry, and includes companies that have both similarities to and differences from Hydro One SSM. The level of diversity

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[21] The stretch factors proposed by SEC and AMPCO are applicable to utilities performing in the bottom quintiles of a comparison panel, which Hydro One SSM is not.

[22] AMPCO Submissions, pp. 2-3; SEC Submissions, pp. 2-3.

[23] AMPCO Submissions, p. 3; SEC Submissions, p. 3.

within the group is adequate to make it representative of the industry even given its size. It therefore provides a reasonable basis to compare costs.

22. Fourthly, the Parties generally advocate for the adoption of a stretch factor to incentivize the pursuit of efficiency gains, apart and separate from the savings to be achieved through operational integration. As discussed in Hydro One SSM's Argument in Chief and interrogatory response 2-AMPCO-4(b), while there are specific areas where Hydro One SSM anticipates cost savings, there are other cost drivers that will arise in 2017 and 2018 that did not previously exist. For example, Hydro One SSM is anticipating cost increases related to personnel and SCADA warranty costs, among others which are expected to offset any one-time cost savings anticipated. The Board's *Handbook to Electricity Distributor and Transmitter Consolidations* allows consolidating entities to defer rebasing up to ten years from the closing of the transaction to offset transaction costs with any achieved savings[24], as long as an earning sharing mechanism ("ESM") is implemented for the period beyond five years. Hydro One SSM was allowed a ten-year deferral period and will implement an ESM in years six to ten. This, in itself, provides strong incentives for the transacting parties to maximize efficiencies. The implementation of a stretch factor, during the critical first two years of integration, is counter-intuitive to the Board's consolidation policy.

23. Fifthly, SEC takes issue with 1QC's use of gross asset value as the denominator for certain metrics, and argues that this approach causes benchmarking to be driven by how expensive a utility's system is.[25] In response, Hydro One SSM notes that SEC has provided no empirical data or analysis to support its assertions (or to show that another normalizer would be more appropriate). In contrast, 1QC included in its report significant empirical data and analyses to show the value of its proposed normalizer. Moreover, it would be helpful to reference HONI's Reply Submission in EB-2016-0160, which included the following response to SEC's criticisms of the gross assets value denominator:

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[24] OEB *Handbook to Electricity Distributor and Transmitter Consolidations* (January 19, 2016), p. 11.

[25] SEC Submissions, p.3.

> "As noted, based on empirical evidence over many years, there is no clear significant economy of scale in transmission operations beyond a certain size. Further, the empirical evidence suggests the asset base not only addresses the size difference between utilities, it also addresses the demographic differences between utilities.
>
> Using an assumption that most utilities have made reasonable design choices overtime, the transmission systems reflect the demographics of the service territory for each utility. In addition, assuming that most utilities have performed their construction within a broadly reasonable range of efficiency, the existing systems represent the results of many decades of design decisions and construction execution. At this point, for each company, the transmission system is essentially a fixed asset, and using it as a denominator is reasonable.
>
> The asset base is demonstrably the best denominator for comparing the cost performance of transmission operators. SEC makes a reasonable point that the use of that normalizer could lead to some perverse conclusions, but the same would be true if any capacity or asset size measures were used for normalization. Again, though SEC states that "customers value system capacity or throughput", those are clearly inferior normalizing factors in terms of their explanatory capability."[26]

24. Lastly, Board Staff submits that the stretch factor being proposed for the deferral period appears to be generous toward HOI's shareholders. In doing so, it cites several examples of distribution consolidations (i.e. Norfolk Power Distribution Inc., Haldimand Power Hydro Inc., and Woodstock Hydro Services Inc.), where Hydro One Distribution applied a 1% reduction to the last rebased rates of the acquired utility.[27] In response, Hydro One SSM notes that the 1% rate reduction was not related to efficiency gains. In fact, the Board recognized that the proposed 1% rate reduction "has no determinative value" in assessing the level of underlying costs and "was not directly driven by any contemplated change in the underlying cost structure".[28] In this regard, Hydro One SSM submits that Staff's comparison of the 1% distribution rate reduction and a transmission stretch factor is not founded, and that the proposed revenue cap index regime, including the stretch factor, are in alignment with the EB-2016-0050 decision and applicable Board policies.

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[26] HONI's Reply Argument in EB-2016-0160, pp.64-65.

[27] Board Staff Submissions, pp. 11-12.

[28] Board's Decision and Order in EB-2013-0198/0187/0198, p. 12.

6.0 Deferral and Variance Accounts

Submissions of the Parties

25. SEC and VECC expressed concerns specifically relating to the proposal to close the In-Service Addition Net Cumulative Asymmetrical Variance Account, which tracks the difference between the revenue requirement of the approved in-service additions and actual in-service additions over 2015 and 2016. Each party points to certain shortfalls in actual in-service additions relative to the Board-approved amount for 2015 and 2016.[29]

Applicant's Reply

26. When the Application was being prepared prior to year end 2016, Hydro One SSM expected to meet the approved in-service addition amount for the 2015 and 2016 period, and therefore requested closure of this account. Based on the now available actuals for 2016, Hydro One SSM determined the total shortfall for 2015 and 2016 to be $927,185, with an associated revenue requirement impact of $143,935. This shortfall was largely due to the timing of certain ongoing projects, whose originally forecast in-service dates in 2016 have been deferred into 2017. Hydro One SSM expects to offset the 2015-2016 in-service additions deficit in 2017, and therefore revenue requirements in future years should not be impacted. Hydro One SSM confirms that this account has been populated with the relevant revenue requirement impact and will be cleared in a future revenue requirement application.

7.0 Performance Monitoring and Reporting

Submissions of the Parties

27. Board Staff and AMPCO each suggests that Hydro One SSM should be required to re-submit a proposal for performance monitoring and reporting, including performance measure metrics, in its next application.[30]

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[29] SEC Submissions, pp. 4-5; VECC Submissions, p. 14.

[30] Board Staff Submissions, p. 4; AMPCO Submissions, p. 4.

28. VECC submits that the Board should only accept Hydro One SSM's proposed scorecard as appropriate for the year 2017, subject to the suggestion that the Board should direct Hydro One SSM to maintain and report annually on the currently proposed measures, as well as other specific conditions and reporting requirements as set out in VECC's submissions.[31]

Applicant's Reply

29. Hydro One SSM will be undergoing significant operational changes in preparation for and as a result of its integration into Hydro One Transmission, which may impact the results of its proposed performance measures. However, where information is available, Hydro One SSM will provide the results of its proposed scorecard for 2016 and up to the end of the most recent quarter available for 2017 in its 2018 application.

8.0 Asset Management Plan

Submissions of the Parties

30. Board Staff submits that an AMP is required under normal circumstances but acknowledges the need to determine operational synergies arising from Hydro One SSM's integration into Hydro One Transmission, which will come into effect in 2019.[32] To this end, Board Staff expects that Hydro One SSM will file a more enhanced Transmission System Plan ("TSP"), including an AMP, in alignment with Hydro One Transmission's TSP to be filed in 2019.

31. AMPCO submits that Hydro One SSM should have filed information on its asset management approach and spending levels for the two-year period prior to consolidation, and that Hydro One SSM should provide current information on the management of its assets as part of the 2018 application.[33]

Applicant's Reply

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[31] VECC Submissions,

[32] Board Staff Submissions, p. 13.

[33] AMPCO Submissions, p. 5.

32. Hydro One SSM will either file a transmitter-specific TSP which will meet the Board's specifications as set out in Chapter 2 of the Filing Requirements, or alternatively, Hydro One Transmission's TSP, to be filed with its 2019 Revenue Requirement Application, will address the asset needs of Hydro One SSM. Regardless, a TSP addressing the relevant filing requirements will be available in 2018 for the review of Hydro One SSM's 2019 revenue requirement.

33. Since the acquisition by HOI closed on October 31, 2016, Hydro One SSM, in coordination with Hydro One Transmission, has been assessing required changes to its approach to asset management that will maximize value to ratepayers while maintaining Hydro One SSM's service quality and reliability performance. As such, Hydro One SSM will not be in a position to provide, as part of its 2018 annual adjustment application, a comprehensive AMP or TSP that will accurately convey how its assets will be managed in 2018 and beyond.

9.0 Conclusion

34. Based upon the forgoing, and subject only to the undertakings made herein, Hydro One SSM submits that its requests for Board approvals with respect to the proposed annual adjustment mechanism (including stretch, productivity, and inflationary factors), the January 1, 2017 effective date for 2017 rates, and the use and disposal of certain deferral and variance accounts, have been made on an appropriate basis in alignment with the Board's MAAD Decision and relevant policy considerations.

All of which is respectfully submitted by:

Tyson Dyck, Torys LLP

Counsel for Hydro One Sault Ste. Marie LP

July 14, 2017