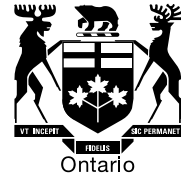


Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto ON M4P 1E4
Telephone: 416-481-1967
Facsimile: 416-440-7656
Toll free: 1-888-632-6273

**Commission de l'énergie
de l'Ontario**
C.P. 2319
27^e étage
2300, rue Yonge
Toronto ON M4P 1E4
Téléphone: 416-481-1967
Télécopieur: 416-440-7656
Numéro sans frais: 1-888-632-6273



BY E-MAIL

December 18, 2017

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

**Re: Hydro One Networks Inc.
2018 - 2022 Distribution Rates Application
OEB Staff Submission on Compensation Evidence
OEB File No. EB-2017-0049**

Please find attached the OEB staff submission on the Compensation evidence filed in the 2018 – 2022 Distribution Rates application filed by Hydro One Networks Inc.

Yours truly,

Original Signed By

Harold Thiessen
OEB Staff
Case Manager – EB-2017-0049

Cc: All Parties, EB-2017-0049

Att.

2018-2022 ELECTRICITY DISTRIBUTION RATES

Hydro One Networks Inc.

EB-2017-0049

OEB STAFF SUBMISSION

On

Hydro One Distribution Compensation Evidence

December 18, 2017

INTRODUCTION

In Procedural Order No. 2 in the current proceeding, issued December 1, 2017, the OEB noted that in the most recent Hydro One Networks Inc. (Hydro One) transmission revenue requirement proceeding (the Transmission Proceeding¹), compensation was dealt with (by Hydro One) on a consolidated basis as it related to Hydro One's transmission and distribution activities, with overall compensation amounts simply being allocated between transmission and distribution functions on a formulaic basis.

Procedural Order No. 2 of the current proceeding provided intervenors and OEB staff with the opportunity to provide any comments on how the OEB should scope its review of the compensation issue. These are the submissions of OEB staff.

Compensation Evidence and OEB Directions from the Hydro One Transmission Proceeding

On December 20, 2016, in the Transmission Proceeding, Hydro One filed Undertaking J10.2, which provided a breakdown of transmission-only compensation costs. In its February 16, 2017 Reply Argument, Hydro One agreed to file a table similar to that contained in Undertaking J10.2 in its next transmission and distribution rates applications.²

In its September 28, 2017 Decision and Order³ in the Transmission Proceeding, the OEB acknowledged Hydro One's agreement to file a table similar to that contained in Undertaking J10.2 in its next transmission and distribution rates applications. In its findings with respect to compensation in the Transmission Proceeding, the OEB issued the following direction to Hydro One with regard to compensation evidence in the current distribution proceeding:

The OEB expects Hydro One to file this complete total compensation information in the distribution rates proceeding as soon as possible. The OEB expects that the information to be filed will include the following:

- a) Tables comparable to the year-end payroll tables in the Transmission Payroll Tables for each of the years 2014 to 2018 containing total compensation information that reconciles with the combined totals of the amounts for each of the years 2014-2018 allocated to transmission shown in Undertaking J10.2 and the amounts shown for distribution in the Distribution Payroll Tables
- b) Within these total compensation tables, for each of the line item amounts and for each year, the total number of employees in a manner that reconciles with the total number of employees information presented in Transmission Payroll Tables

¹ EB-2016-0160

² EB-2016-0160 – Hydro One Reply submission, February 16, 2017, at p.83, para. 277

³ EB-2016-0160 – Decision and Order, September 28, 2017, Revised November 1, 2017, at p.53

- c) Beside the “Total Number of Employees” information described in item (ii), the total company full time equivalent (FTE) information for each of the years 2014- 2018 in a format similar to that shown in EB-2017-0049 Exhibit C1/Tab 2/Schedule 1, Table1
- d) In the total compensation tables, the allocation of total compensation between capital and Operating, Maintenance and Administration (OM&A) for each of the years 2014-2018 in a manner comparable to that shown for transmission only in Undertaking J10.2
- e) As part of the total compensation table, the Pension and OPEB amounts for distribution for each of the years 2014-2018 in a table similar to the table to that effect contained in Undertaking J10.2
- f) A revision of the format used in Undertaking J10.2 to reflect the format of the total compensation tables described in items a) to e)
- g) An exhibit that shows how the allocation factors used to allocate the total compensation amounts between transmission and distribution are derived. The OEB directs the above information to be presented in the distribution rates proceeding on a basis that is consistent with the combined year-end payroll information for the transmission and distribution business segments.

OEB Directions on Compensation in the Current Distribution Proceeding

On October 11, 2017, Hydro One filed a letter in the current proceeding, enclosing updated evidence on compensation as requested in the Transmission Proceeding Decision and Order. In that letter, Hydro One indicated that it had changed its methodology for reporting compensation in the distribution proceeding compared to that used in its transmission evidence. Hydro One also noted that the new methodology for reporting compensation could result in a more accurate reflection of compensation but would also make it impossible to compare the compensation evidence from the transmission proceeding to that of the distribution proceeding.

The OEB acknowledged the Hydro One letter in Procedural Order No. 2, and indicated that it did not intend to rehear the same evidence related to compensation in this distribution proceeding that it did in the Transmission Proceeding.

As a result, and to determine the extent to which the OEB would consider compensation in this proceeding, the OEB directed Hydro One to explain the differences among what it proposed for compensation in the Transmission Proceeding; what the OEB decided with regard to compensation in the Transmission Proceeding; and what is in its compensation evidence in the current proceeding. Specifically, Hydro One was required to file its total compensation, and allocation to distribution and transmission, using the methodology used in the Transmission Proceeding and shown in Undertaking J10.2 in that proceeding, filed December 20, 2016.

The OEB specified that the filing should include the years 2013 to 2018 as provided in Undertaking J10.2 to allow the identification of any differences between the

compensation in this proceeding and the compensation in the Transmission Proceeding not caused by the change in methodology; such as the impact of changing the allocation of compensation between transmission and distribution to reflect the business plan underpinning the current application. Hydro One was expected to comment on any differences.

In addition, intervenors and OEB staff were provided the opportunity to review the evidence submitted by Hydro One and to provide any comments on how the OEB should scope its review of the compensation issue.

Hydro One Filings on Compensation in the Current Proceeding

Hydro One has made a number of filings related to compensation in this proceeding:

- 1) The original compensation evidence, filed on March 31, 2017 as Exhibit C1/Tab 2/Schedule 1, and specifically Appendix B thereto, showing a table of historical and forecast distribution compensation from 2014 to 2022.
- 2) The October 11, 2017 filing, submitted in response to the OEB's directions in its September 28, 2017 Decision and Order in the Transmission Proceeding, identified as Attachment 6 to Exhibit C1/Tab 2/Schedule 1. That filing showed compensation costs for both transmission and distribution from 2014 to 2022.
- 3) The December 12, 2017 submission, filed in response to the OEB's directions (identified above) in Procedural Order No. 2. Two further attachments were filed:
 - a) Attachment 7 to Exhibit C1/Tab 2/Schedule 1, which outlines the differences in methodologies used to calculate compensation costs in this proceeding and in Hydro One's 2017-2018 transmission rate proceeding.
 - b) Attachment 8 to Exhibit C1/Tab 2/Schedule 1, which is Hydro One's total compensation, and allocation to distribution and transmission, using the methodology shown in Undertaking J10.2 of Hydro One's 2017-2018 transmission rate proceeding.

In its December 12, 2017 submission, Hydro One outlined the differences in how compensation information was produced in the past. Hydro One advised that in previous years, and as shown in its original evidence in the Transmission Proceeding, pension and OPEB burdens were not included in the overall compensation totals. Those were added later in Hydro One's response to Undertaking J10.2, for transmission only.

More particularly, in Undertaking J10.2 in the Transmission Proceeding, Hydro One:

- applied the “labour content” method from the Black and Veatch study “Review of Overhead Capitalization Rates” (EB-2016-0160, Exhibit B1-3-10-1) to allocate costs to the transmission compensation data
- reflected costs only for those employees on payroll on December 31st.

Attachment 6 to Exhibit C1/Tab 2/Schedule 1, filed in the current proceeding on October 11, 2017, included both transmission and distribution compensation. Hydro One advises that that Attachment:

- uses the expansive definition of “total compensation”, consistent with Undertaking J10.2 in the Transmission Proceeding
- reflects total compensation costs for full years, rather than a point in time, which is not consistent with Exhibit J10.2
- refines the allocation of casual employee compensation based on management’s expertise regarding the relative contribution of casual employees to the transmission and distribution work programs
- reflects actual 2016 compensation rather than the forecast used in J10.2
- uses an updated actual allocation between transmission and distribution as compared to a forecast used in J10.2, with a shift of cost to distribution and an equal offset to transmission
- reflects the Distribution Business Plan (of December 2016).

In addition, the Attachment 6 filing includes a change in how the Black and Veatch allocation is applied: in the J10.2 evidence it was applied to all employees. However, in Attachment 6 it is only used for regular employees while costs for casual employees are allocated by the percentage used by each line of business and the use of management expertise.

OEB STAFF SUBMISSION

In the preceding paragraphs, OEB staff has summarized the differences in the compensation evidence filed in this case and that filed in the Transmission Proceeding.

OEB staff submits that the compensation evidence filed by Hydro One in this proceeding has changed significantly from the compensation evidence filed in the Transmission Proceeding, including significant differences from the information filed in Undertaking J10.2 in the Transmission Proceeding. Not only have the absolute numbers changed but methodologies have also been revised to arrive at the compensation amounts for Hydro One’s distribution business. This was not examined or reviewed by parties in the Transmission Proceeding.

Therefore, OEB staff submits that compensation should remain on the issues list for the distribution proceeding, with the following exception related to executive compensation that the OEB could consider.

The matter of executive compensation was addressed at length in the Transmission Proceeding and also by the OEB in its Decision and Order in the Transmission Proceeding⁴.

The holding company should have greater responsibility for the compensation amounts that relate to its transformation and its commitments to increase shareholder value which are of little if any value to consumers of electricity transmission services.⁵

The OEB reduced the transmission Operating, Maintenance and Administration OM&A envelope in each of 2017 and 2018 to reflect this finding on executive compensation.

OEB staff notes that much of the evidence filed in the current proceeding on Executive Compensation was also filed in the Transmission Proceeding. This includes the Towers Watson Executive Compensation Review of October 16, 2015; the Towers Watson Non-Executive Pay Bands Review of October 16, 2015; and the Hugesson CEO/CFO pre-IPO Benchmarking study.

OEB staff submits that as these studies were already addressed in the oral hearing for the transmission proceeding, the OEB could limit the further review of these studies and their impact on the Senior Management compensation levels in the distribution case.

In addition, Hydro One has advised⁶ that it intends to reduce corporate management expense proposed in the current application to reflect the OEB's findings in that regard in the Transmission Proceeding. That proposed change to the overall corporate management expense is to be included in Hydro One's upcoming evidence update, which Hydro One's executives, appearing at the December 7, 2017 Presentation Day, advised would be delivered before December 22, 2017. This update has not yet been received, and OEB staff therefore cannot yet comment on whether and how the update conforms to the OEB's findings in the Transmission Proceeding.

OEB staff agrees with Hydro One that a corporate management compensation reduction would be warranted on the basis identified in the Transmission Proceeding, and that appropriateness of a reduction in compensation for the reasons identified in that proceeding should not be re-litigated here. However, the amount of the reduction, as proposed in the December 12, 2017, letter has not been scrutinized or tested. In light of the changes in methodology and evidence between the Transmission Proceeding and the current distribution proceeding, OEB staff submits that the quantum

⁴ EB-2016-0160 Decision and Order, September 28, 2017, Revised November 1, 2017, at p.45 - 60

⁵ EB-2016-0160 Decision and Order, September 28, 2017, Revised November 1, 2017, at p.59 - 60

⁶ December 12, 2017 letter, p. 9

of the reduction may not be readily determined, and therefore should be included in the Issues List in the current proceeding, within the broader compensation issue.

All of which is respectfully submitted.