
NB: "PEG Study" refers to the document: IRM Design for Hydro One Networks Inc., April 13, 2018, Exhibit M1

VECC IR #1

VECC-1

Reference Exhibit M1, page 9

- a) Ontario's minimum wage has increased from \$11.60 to \$14.00 on January 1, 2018 and will increase to \$15.00 on January 1, 2019. Directionally, how might this government policy impact the inflation factors proposed by the Applicant?
- b) If there is an anticipated inflationary impact of the Ontario minimum wage law (for example of AWE or the proposed fixed-weight average hourly earnings in Ontario) what, if any adjustment might be recommended for the 2019 rate year to the Applicant's proposal?

Response to VECC-1: The following response was provided by PEG.

- a) An increase in Ontario's minimum wage would likely accelerate growth in Hydro One's proposed inflation measure. Average weekly earnings may be peculiarly affected because they are sensitive to payments for overtime. However, the bulk of the impact of the minimum wage hike on provincial labor price indexes may well take effect in 2018, before the revenue cap index becomes operative.
- b) If the minimum wage hike accelerated AWE growth, on balance, consumers could make a case for a Z factor adjustment on the grounds that the minimum wage hikes won't have very much effect on Hydro One's cost. On the other hand, the second minimum wage hike will be smaller, and the labor price is arguably intended to track general labor market conditions.

VECC IR #2

VECC-2

Reference: Exhibit M1, page 6

- a) At page 6 the PEG Study states: *“On this basis, a 0.45% stretch factor seems reasonable for Hydro One **provided that the Board is comfortable fixing the stretch factor for the full plan term.**”* (Emphasis added). Why might the Board not want to set the stretch factor for the full plan term?

Response to VECC-2: The following response was provided by PEG.

Dr. Lowry notes that the OEB decided to annually update stretch factors under 4th Generation IRM. Notable benefits of this policy include the following:

- High capital spending can have a more immediate impact on the X factor, strengthening cost containment incentives and providing customers with more relief.
- The advantage of bunching capex in the early years of the plan’s indexing period so as to bolster supplemental revenue is diminished.

On the other hand, a reconsideration of the stretch factor each year would involve some incremental regulatory cost. This cost could be contained were the OEB to choose one of the available benchmarking models, which include the Board’s own model and the two models featured in this proceeding.

VECC IR #3

VECC-3

Reference: Exhibit M1, page 34

- a) The PEG Study argues for a growth factor adjustment in lieu of a “C” factor adjustment. The rationale for this approach is (in part) that: *“Adding a growth escalator to the RCI is an efficient way to fund **growth-related capex**, including the acquisition of utilities”* (emphasis added). A significant portion of Hydro One’s capital program is directed at sustainment rather than growth (see for example Exhibit Q, Tab 1, Schedule 1, page 9). Does this fact weaken the argument for replacement of the proposed “c” factor with the proposal of PEG. Please explain why or why not.

Response to VECC-3: The following response was provided by PEG.

Dr. Lowry notes the following.

- He is not proposing to replace the C factor with a growth factor but, rather, to reduce the C factor.
- To the extent that growth-related capex is unusually low relative to demand growth, it is possible that the addition of a customer growth escalator to the revenue cap index could overcompensate a utility in the general case.
- Due to the C factor, however, adding a growth factor to the revenue cap index would likely only effect OM&A revenue in this plan. The C factor would be lower but capital revenue would be the same.
- Consumers can be made whole for the modest increase in OM&A revenue by adding a materiality threshold and deadband to the C factor. There are many other arguments for the proposed C factor reform.
- One of the reasons growth-related capex is not expected to be high during this IRM is that customer growth is not expected to be rapid.
- Having customer growth as a scale escalator in a revenue cap index strengthens the argument for using customer growth to measure output in the X factor calibration research. Since customer growth is relatively brisk, X factors will tend to be lower.
- Customers will generally benefit in the long run by using index logic in IRM plan design.

VECC IR #4

VECC-4

Reference: Exhibit M1, page 40

- a) At page 40 the PEG Study provides a number of suggested changes to the Hydro One proposal. One is that the X Factor could be raised to reduced “double dipping”. If the Board were so inclined, how might it determine the amount of the increase in the X Factor to achieve the suggested results?
- b) Capex materiality “dead zones” are also suggested. How might these dead zone ranges be determined?

Response to VECC-4: The following response was provided by PEG.

- a) One approach would be to raise X in future plans by an amount sufficient to effectively repay the supplemental revenue over time. Another would be to raise X by an amount commensurate with excluding, say, 10% of capex from the TFP study that provides the basis for X factor calibration. The first approach is more tailored to the supplemental revenue that is actually granted.
- b) One model for a dead zone is that in the OEB’s current ICM mechanism. The first 10% of a distributor’s capex that exceeds the estimated capex budget provided by growth of the price cap index and billing determinants is ineligible for incremental capital funding. A disadvantage of this approach is that distributors have no incentive to contain incremental capex once their capex exceeds the 10% threshold. An alternative approach with better incentive properties is that, if capex exceeds a 10% materiality threshold, 90% (or another %) of *all* unfunded capex is ineligible for recovery through the C factor.

VECC IR #5

VECC-5

Reference: Exhibit M1, page 41

- a) In the Author's opinion as Hydro One migrates to full fixed distribution rates does this reduce the earnings risk to the Utility (i.e. by eliminating weather related risk)? If yes, then how this change in risk might be captured in the rate/revenue annual adjustment of Hydro One over the life of the plan?

Response to VECC-5: The following response was provided by PEG.

Dr. Lowry notes that rate design has little impact on the design of a typical revenue cap index. Although not a cost of capital expert, he also notes that full fixed distribution rates for residential customers materially reduce a distributor's operating risk. The effect is similar to the risk reduction under full decoupling of residential revenue. In the United States, several regulators have reduced allowed ROEs of utilities operating under decoupling. These include the following:

- The New Hampshire PUC recently reduced the allowed ROE of Liberty Utilities (Energy North Natural Gas) by 10 basis points to reflect reduced risk due to decoupling.
- The District of Columbia PSC for several years reduced the allowed ROE of Potomac Electric Power by 50 basis points (later reduced to 10) to reflect the reduced risk provided by revenue decoupling.
- The Oregon PUC reduced the allowed ROE of Portland General Electric by 10 basis points to reflect reduced risk due to the approval of decoupling.

Alternatively, utilities may present ROE proxy groups that only include utilities (or the holding companies of utilities) that have revenue decoupling and/or lost revenue adjustment mechanisms. This would implicitly discount the allowed ROE to account for the perceived reduction in risk from revenue decoupling.

PEG is not aware of any examples in the States of reducing the ROEs of investor-owned electric utilities for full fixed pricing because this rate design is not favored for these utilities in the States.

The legitimacy of this issue is increased by the fact that Hydro One is asking for a C factor that compensates it for the full extent to which the RCI otherwise underfunds its capital cost.