August 10, 2018

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
P.O. Box 2319
Toronto, Ontario
M4P 1E4

Dear Ms. Walli:

RE: EB-2017-0049 – Hydro One Networks Inc. – Distribution Rate Application - 2018 -2022 - Final Argument

Please find, attached, the Final Argument of the Consumers Council of Canada regarding the above-referenced proceeding.

Yours truly,

Julie E. Girvan

Julie E. Girvan

CC:
All Parties

HYDRO ONE NETWORKS INC.

APPLICATION FOR ELECTRICITY DISTRIBUTION RATES 2018-2022

EB-2017-0049

FINAL ARGUMENT OF THE CONSUMERS COUNCIL OF CANADA

A. INTRODUCTION:

On March 31, 2017, Hydro One Networks Inc. (HON) applied to the Ontario Energy Board (OEB or Board) for approval of its distribution rates effective January 1, 2018. HON is also seeking approval for a Custom Incentive Regulation Model for rate setting for period January 1, 2019 to December 31, 2022.

These are the submissions of the Consumers Council of Canada (Council) regarding HON's Application. The Council will first provide some overview comments and context for the Board's consideration of the Application, and then address the following components of HON's Application:

1. Custom Incentive Regulation Model
2. Capital Spending
3. Operating Maintenance and Administration Costs
4. Compensation
5. Acquired Utilities
6. Deferral and Variance Accounts
7. Load Forecast
8. Special Service Charges
9. Seasonal Rates
10. Effective Date

The Council notes that it has worked extensively with other intervenors throughout this proceeding. Accordingly, the Council has not commented on some issues extensively, knowing others would. In certain cases we have simply adopted the submissions of other intervenors or Board Staff.

B. OVERVIEW:

The Application:

HON's Application is for rates for the five-year period, 2018-2022. The Application was originally filed on March 31, 2017. The following is a list of the approvals being sought by HON:

- A revenue requirement of $1.5142 billion[1] for 2018, which has been derived on a cost of service basis;

- A distribution rate increase for 2018 of 6.5% on average over 2017 rate levels and an average distribution rate impact of 3.4% per annum over the term of the proposed rate plan. The main drivers for the increase over 2017 are proposed capital spending and a reduction in load;

- A Custom IRM framework for deriving the rates for the years 2019-2022, which includes a stretch factor of .45%, 0% productivity and a Capital Factor for recovery of the proposed capital spending during the rate plan;

- An earnings sharing mechanism (ESM) for the duration of the plan based on 50:50 sharing above a deadband of 100 basis points;

- A load forecast for 2018-2020 and approval to update the forecast for the 2021 and 2022;

- The disposition of Deferral and Variance Account balances amounting to $8.3[2] million;

- Operating, Maintenance and Administration Costs of $576.7 million for 2018;

- Capital Budget Amounts for 2018 of $633.9 and approximately $3.7 billion for the duration of the plan[3]

[1] Argument in Chief (AIC) , p. 19
[2] Tr. Vol. 10, p. 86
[3] Ex. A/T3/S1/p. 26, Table 9

- A proposal to integrate the rates of the three acquired utilities - Norfolk Power Inc., Haldimand County Hydro Inc. and Woodstock Hydro Services Inc. (collectively, the Acquired Utilities) in 2021.

- An effective date of January 1, 2018; and

- New specific service charges

Context:

In consideration of HON's proposals the Council is of the view that the following context is important and should guide the OEB's consideration of the approvals sought by HON.

Fair Hydro Plan:

The *Fair Hydro Act, 2017* came into effect on June 1, 2017. The stated intent of the legislation was to lower electricity bills by 25% on average for all residential customers, farms and small businesses. The bill also mandates that increases in bills will be held to the rate of inflation for four years. HON customers are also afforded further rate protection with the implementation of the Distribution Rate Protection program, also established through the Fair Hydro Act.

During the proceeding HON confirmed that given the Fair Hydro Act, its R1 and R2 customers, with the exception of Seasonal customers, will not see any increases in base distribution rates on their bills.[4]

Despite the fact that the Fair Hydro Plan is providing rate relief to HON's low volume customers, the Board should not allow that to influence its assessment of HON's application. In a letter dated April 10, 2017, from the Minister of Energy to the OEB Chair the Minister stated,

> The proposed (Fair Hydro) Plan is not intended to limit the OEB's mandate to set just and reasonable rates or payment amounts. The government fully

[4] Tr. Vol. 1, p. 87

> expects that the OEB will continue exercising its mandate in the public interest as it does today.[5]

The Council submits that the OEB should not take into account the Fair Hydro Act when considering what is an appropriate revenue requirement for HON. Counsel for the Power Workers Union questioned HON during the hearing as to whether, in light of the fact that 60% of the customer base will not see increases, HON would spend more on capital, sooner rather than later[6]. The Council submits that the Board needs to assess the reasonableness of HON proposals on their own merits and not be influenced by the fact that the Fair Hydro Act is in place. The Board is mandated to consider whether HON's rates are just and reasonable, and it does so by considering the underlying budgets and other relevant proposals contained in the Application. The fact that the Government of Ontario has chosen to enact rate and bill subsidies for some electricity ratepayers should not influence the OEB's review of HON's Application and its determination of final rates.

Timing of the Application:

HON developed the underlying investment budgets in support of its Application beginning in 2015, which were ultimately presented to the then, CFO and CEO on September 27 and 28, 2016. The Board of Directors reviewed the Draft Investment Plans in October 2016, ultimately approving the overall Business Plan in December 2016[7].

HON's Application was filed on March 31, 2017 and updated in June 2017. A further update was provided at the end of December 2017[8]. The hearing proceeded in June 2018. It may be several months into 2019 before final rates are in place, following an OEB Decision and Rate Order approval process. The Council is concerned about this for a number of reasons.

The budgets that were developed in the 2015 and 2016 period are the basis for 2018-2022 rates that may not be in place until well into 2019. That means that the context in which those budgets were developed may no longer be appropriate.

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[5] Letter dated April 10, 2017
[6] Tr. Vol. 1, pp. 92-93
[7] 24-SEC-36
[8] Ex. Q

HON is seeking approval for capital budgets for the years 2021 and 2022 that are based on a 2015 and 2016 planning period. As we have learned though the years a lot can change in a 6-7 year period in the Ontario electricity distribution sector.

The OEB approved HON's capital budget for the years 2015-2017 in the last proceeding. HON's spending exceeded those approved amounts by over $100 million. In addition, what the evidence is this case demonstrates is that HON did not stay with the plan it put forward in the last proceeding. A significant amount of the currently proposed capital spending is for investments that were deferred – they were paid for in rates by customers over the last several years, but HON is seeking now to have the cost of those investments included in future rates. In addition, unit costs went up and the replacement of assets did not match the plan. So, how can the OEB be confident that the budgets for the latter years of the plan are appropriate? The Council will be proposing that HON be required to provide detailed reporting with respect to its capital plans when it files its proposals in 2020 to implement the new rates associated with the acquired customers. At that time the OEB can assess whether the capital plan for 2021 and 2022 is appropriate. Until that time the Board should not be approving a capital factor for those years.

The other concern about timing means there may be a significant retrospective adjustment to allow for the recovery of the 2018 rate increases beginning in 2019 on top of the proposed 2019 rate increases. The Board will need to consider whether it is appropriate to allow for recovery of amounts in 2019 that are derived assuming the rates underlying the application were in place on January 1, 2018. As set out below, the Council does not support an effective date of January 1, 2018.

<u>The Leadership Has Changed:</u>

The Business Plans underlying this Application were approved by a CEO, CFO and Board that are no longer with HON. The executive leadership team is changing is the Board of Directors. It is possible and probable that new leadership will have potentially different objectives and plans for HON. The OEB in its consideration of the Application will need to consider whether there are any implications arising from the fact that the leadership team and Board of Directors that essentially approved the underlying Business Plan are no longer with the Company.

The Council's Concerns with the Application:

The Council will set out in the sections below its specific submissions regarding the major areas of HON's Application. The Council does not support the Application as filed and submits that the OEB should be making adjustments to both the rate plan and the 2018 revenue requirement. The Council's primary concerns are the following:

- HON's proposed rate increases are largely driven by its capital plan. HON' s track record with respect to the execution of the capital plan that it put forward in the last proceeding is not good. HON added more than $120 million in in-service additions over what it proposed to do. In addition, HON did not do what it said it was going to do. In effect, the plan put forward to the OEB for the 2015-2017 period was not followed. This was despite the fact the OEB essentially approved HON's capital budgets, as filed, for the 2015-2017 period. There is no evidence that HON has the ability to improve it capital plan execution, beyond promises made during the oral testimony. Until the OEB has hard evidence that HON has the capacity to deliver its proposed plan over the course of the five year rate plan, and do so in an efficient and effective way HON should not be given approval of the capital budgets as proposed for the five years.

- HON's compensation levels continue to be out of market. This never changes. For years, and repeatedly in each of HON's previous rate applications, the OEB and intervenors have expressed concerns about HON's compensation levels. Yet in this case the evidence is that HON is worse with respect to how its compensation compares to others than it was in 2013. From the Council's perspective, if HON chooses to continue to compensate its employees more than other comparable companies, then it should not be the ratepayers that are responsible for those premiums. Compensation that exceeds the market median should be excluded from the revenue requirement. The OEB must put a stop to compensation levels that exceed market median.

- The Council accepts that HON is attempting to be more customer focused. HON has undertaken initiatives that have improved its billing accuracy, eliminated security deposits, eliminated winter disconnections, and established a Winter Relief program. However, HON continues to ramp up its capital spending and has not made concerted efforts to reduce its

compensation costs. It is these factors that ultimately impact rates. Although residential customers are currently being given rate relief by the Government there is no certainty how long that will last. Investments made today will be paid for decades. It is crucial that those investments are justified, paced and based on robust a capital plan that is supported by business cases. Much of HON's forecasts are not supported by robust plans or detailed spending estimates.

- In its December 2017 update HON provided evidence that it was significantly changing the way in which it would execute its vegetation management program, moving from an 8 year cycle to a 3 year cycle at no extra cost to ratepayers. In addition, despite the consumer engagement conclusions that reliability should be maintained this program is focused on significantly improving reliability. It is not entirely clear why the change was suddenly made in the Fall of 2017. If reliability is increasing significantly with the implementation of an increased clearing cycle, there should logically be a reduction in other programs focused on improving or maintaining reliability. There have been no adjustments to the capital programs to reflect this.

- The proposals for incorporating the Acquired Utilities into should not be approved at this time and HON be required to retain an independent consultant to consider all of the costs allocation and rate design issues that are relevant to consolidation and the integration.

C. SUBMISSIONS:

1. CUSTOM INCENTIVE REGULATION MODEL:

HON has proposed a five-year Custom Incentive Regulation Model (IRM)[9]. The first year is based on a cost of service approach and the revenue requirement for the years 2019-2022 is determined using a revenue cap index. The revenue cap index includes:

- An X factor that is derived using a Custom Industry Total Factor Productivity measure (0%) and HON's Custom Productivity Stretch Factor (.45%);

[9] Tr. Vol. 1, p. 15

- An inflation factor that is determined annually by the OEB;

- A Custom Capital Factor (CCF) to recover the revenue requirement in each test year arising from its capital plan:

The other elements of the Custom IRM are the following:

- An ESM that results in sharing 50:50 returns above a 100 basis point deadband in each year;

- A Capital In-Service Variance Account to track the difference between the revenue requirement associated with the actual in-service capital additions during the rate year;

- A materiality threshold for Z-factor relief for the duration of the plan of $1 million;

- A proposal to update the load forecast and the cost of capital parameters for the years 2021 and 2022;

The Council agrees with Board Staff that this plan is not a "revenue cap" but rather a revenue requirement index. The Council is not opposed to this approach and generally supports HON's proposals with the following exceptions:

- The base revenue requirement for 2018 should be reduced to reflect the reductions proposed throughout these submissions, and specifically with respect to OM&A levels and HON's proposed capital plan.

- The stretch factor should be accepted for 2018, but subject to change if HON is moved to a different cohort. There should be consequences for HON if its performance changes relative to its Ontario peers;

- With respect to the ESM the Council does not support a 100 basis point deadband. HON should be given the opportunity to earn its allowed rate of return on equity (ROE). Earnings above the allowed ROE should be shared with ratepayers. This is consistent with HON stated intent to become more

customer focused. The Council sees no rationale for the 100 basis point deadband. We note that Enbridge Gas Distribution Inc. has had an ESM without a deadband for the last five years and has shared earnings with it customers in each of those years;

- HON should not be permitted to reset its return on equity for the last two years of the plan. The OEB explicitly states in the Rate Handbook it does not expect annual rate applications for updates for cost of capital, working capital allowances, or sales volume[10]. It is HON's position that with the integration of the Acquired Utilities represents exceptional circumstances that merit an update to the ROE and load.[11] The Council disagrees. It is standard practice for the OEB to set the ROE for the base year and leave it in place for the duration of the plan.

- The CCF is essentially allows for an increase in the revenue requirement in each year as a result of the increased rate base resulting from the capital plan. HON is seeking approval of the CCF for each year of the plan at this time, in this proceeding. As discussed throughout this submission (and in more detail below) the Council has concerns with HON's track record with respect to executing its capital plans as proposed. In addition, HON is seeking significant increases in the level of capital spending throughout the plan term. The Council does not support establishing the CCF at this time for the latter years of the plan. The Council submits the OEB should approve a capital plan for HON for the years 2018-2020. When HON applies for its 2021 rate adjustment in 2020, it should be required to report on a detailed basis its actual spending in 2018 and 2019 relative to the approved plan. At that time the Board and the intervenors can determine if HON did what it said it would do, and assess whether the execution of the approved plan has been appropriate. With that report in hand the OEB can then determine the appropriate level of spending for the final two years of the plan and set the CCF;

[10] Tr. Vol. 2, p. 79
[11] Tr. Vol. 2, p. 80

- With respect to the materiality threshold for Z-factor relief HON is proposing $1.0 million[12]. HON's argument for the $1 million level is that it is consistent with Chapter 3 of the Filing Requirements for Electricity Distribution Rate Applications and the OB's Report on Third Generation Incentive Regulation[13]. HON is the largest electricity utility in Ontario. From the Council's perspective setting a materiality threshold for HON at $1 million simply because, "that is what the Handbook says" is inappropriate. The threshold must be meaningful. An event or circumstance outside of management's control must be significant in order for the OEB to grant financial relief. In the context of a Company that has a revenue requirement of $1.5 billion, $1 million is not meaningful. It is also ridiculous to justify a 2018-2022 threshold on the basis of a report that was issued 10 years ago. The Council notes that OPG has a materiality threshold of $10 million and a revenue requirement of approximately $3.3 billion. Union Gas Limited currently has a materiality threshold of $4 million. The Council submits that the OEB should establish a materiality threshold for HON of $4 million. HON may apply for Z-factor relief as long as the OEB's established criteria are met, and the revenue requirement impact is $4 million or more. The Council notes that Z-factor relief must also be symmetrical. To the extent something happens that is outside of the control of management and meets the other criteria, but represents a cost reduction, HON should be required to bring an application forward in order to allow that cost reduction to be credited to ratepayers.

- With respect to the updates to the load forecast for the years 2021 and 2022 the Council is opposed to this approach. Utilities are expected to live by their load forecasts for the duration of a Custom IRM plan.

2. CAPITAL SPENDING:

The most significant driver for the overall rate increases over the 5-year rate plan period is capital spending. This is related to the addition of rate base for past spending and the proposed capital plan as set out in the Distribution System Plan (DSP). The Council will address both HON's historical capital spending and its proposed spending that has been derived from the Distribution System Plan. The

[12] Ex. I-16-CCC-18
[13] AIC, p. 42

Council has relied on the work and analysis undertaken throughout this proceeding by both the School Energy Coalition (SEC) and the Association of Major Power Consumers in Ontario (AMPCO) regarding HON's capital planning, budgeting and execution. The Council has reviewed the Submissions of AMPCO and supports those submissions regarding reductions in the capital budget. In this section we will not duplicate those submissions, but rather highlight the key points that ultimately lead to the conclusion that HON's proposal to spend approximately $3.6 billion over the test year period is not appropriate. The need to undertake that level of capital has been overstated and HON has not demonstrated that it has the capacity to execute that plan as currently presented.

Historical Capital Spending:

In its last OEB Decision regarding HON's rate application for the 2015-2019 HON the Board essentially approved HON's capital budget as proposed for the three approved rate years. So HON, in effect got all of what it asked for those three years. With respect to In-Service Capital HON spent $122.5 million relative to what was approved[14]. HON is seeking to add that the rate base associated with those in-service additions to the 2018 opening balance.

As the evidence demonstrates with respect to Sustainment Investments HON, in most of the major categories, did not execute its capital investments as planned. This is the case in the following categories:

- Transformer Replacements
- Station Refurbishments
- Pole Replacements
- PCB Lines Equipment Replacements
- Large Sustainment Initiatives[15]

HON acknowledged that in these categories that it did less work than it had proposed in those years through its distribution application[16]. HON also acknowledged that there is still a need to do this work that was deferred and it

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[14] Tr. Vol. 6, p. 134
[15] Ex. K6.2, p. 26 I 24-AMPCO-22
[16] Tr. Vol. 6, p. 139

forms part of the current plan in the current application. HON's witness also stated, "our performance in the last period wasn't as strong as we planned to have it for the go forward period."[17]

HON overspent relative to its plan in the 2015-2017 period. HON, in many cases, did not get the work done it said it would get done. In many cases the unit costs are much higher than forecast. HON admitted that its performance was not as strong as they had planned. The Council submits that on this basis HON should not be able to collect from ratepayers the additional spending that was incurred in the 2015-2017. As many of the projects were deferred this would have ratepayers paying twice. Another important point is that the OEB gave them their full ask – they proposed a budget and that budget was approved in its entirety. To now seek additional funds from ratepayers related to the fact they did not stay on plan is not appropriate.

Proposed Capital Spending:

The capital plan that is now before the OEB for approval has gone through many iterations since the planning cycle began in 2015. Plans were presented to the HON Executive Team and the Board of Directors. Ultimately, HON landed on its Plan B modified. The Council will not repeat the detailed chronology of events as this has been elaborated on extensively throughout this proceeding, in writing and at the oral hearing. The $3.6 billion budget was ultimately approved in December 2017. The basis for the plan was that Board wanted to set an appropriate balance between rate impacts and reliability. As we heard at the hearing form Mr. D'Andrea:

> Q: So do I take it from this that ultimately what the board of directors said to you was, we want a rate impact that would allow us to keep overall system reliability at current levels while continuing to offer the discrete power quality and reliability improvements for certain segments?
> A: That is how we posed it to the Board[18]

In fact, what is now before this Board is a capital plan coupled with a vegetation management program that is greatly improving reliability. That is not consistent with the outcome of the customer engagement process which indicated customers are focused on maintaining reliability and reducing rates.

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[17] Tr. Vol 6, p. 151
[18] Tr. Vol. 2, p. 104

The Council urges the Board to make significant reductions to the proposed capital plans based on the following points that have been expanded upon by SEC and VECC:

- HON significantly overspent in the prior period with respect to its capital plan. It is now seeking recovery of those amounts in addition to seeking recovery for a second time for activities and programs that have been deferred in the last period;

- HON initially stated that its DSP has been vetted through its consultants, AESI,[19] whereas HON also confirmed that AESI was not asked to do an independent review of the asset management plan or HON's planning processes. They were asked to determine if the DSP met the Charpter 5 filing requirements ;[20]

- HON confirmed that they did not change its asset strategy since the last application and the use of that strategy last time resulted in a mismatch between what was expected to be replaced, and what was actually replaced. Less was done than expected, but cost overruns were experienced;[21]

- Based on the performance during the last rate plan term the Board should not have any confidence that HON can do what is says it will do. This supports a budget reduction in the following areas – Station Refurbishment, Pole Replacements, Large Line Sustaining Initiatives, and PCB Line Equipment Program.

As noted above the Council is of the view that at most the OEB should approve a capital plan for the 2018-2020 period. HON should be required in 2020 to apply for approval of capital expenditures for the period 2021 and 2020. The evidence filed in support of its plan must include the proposed plans for 2018-2019 approved in this case and the actual executed plans. At that point the Board and intervenors can assess the reasonableness of the proposed plan for 2021 and 2022.

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[19] Tr. Vol. 2, p. 28
[20] Tr. Vol. 2, p. 108
[21] Tr. Vol. 6, p. 170

3. OPERATING, MAINTENANCE AND ADMINISTRATION COSTS:

As set out in the AIC, HON's latest forecast for Operating, Maintenance and Administration Costs for 2018 is $576.7 million. This will form the basis for OM&A going forward, as HON's proposal is to escalate the revenue requirement set in 2018 to determine the revenue requirements for each of the subsequent years.

The Council has in Section 4 below set out its submissions regarding HON's compensation, a significant component of HON overall OM&A costs. In this section we will address some of the other components of the OM&A budget.

HON has, throughout this proceeding, argued that because the 2018 OM&A costs are $16.3 million below the 2017 Board approved costs this Application "represents a focus on controlling and reducing costs within HON's control."[22] In fact OM&A costs are increasing significantly when you compare the forecast for 2018 to what HON actually spent in 2017.

In its AIC HON states that since 2014, when OM&A expenditures were high due to customer care expenses related to the implementation of a new customer information system, OM&A expenditures have been kept in line and are in fact shrinking.[23]

The actual 2017 OM&A cost was $558.7 million[24]. HON's explanation for the reduction in OM&A in 2017 relative to the June forecast and the Board approved amounts was that "productivity was back-end-loaded".[25] So in fact, HON's OM&A costs are not "shrinking". The 2018 budget is $17.9 million above the 2017 actual amounts. This can be illustrated by looking at the Table 1 provided by HON in its AIC – Summary of Recoverable OM&A Expenses.

In this Table the following becomes clear – OM&A is increasing in almost category of expenses with the exception of Common Corporate Costs and Other:

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[22] AIC, pp. 8, 19
[23] AIC, p. 120
[24] Tr. Vol. 2, p. 92
[25] Tr. Vol. 2, p. 93

- Sustainment is increasing by $42 million
- Development is increasing by $2.2 million
- Operations is increasing by $4.8 million
- Customer Care Costs are increasing by $5.3 million
- Property Taxes are held at 2017 levels.

If you take out the Common Corporate Costs and Other out of the analysis OM&A costs for 2018 are increasing by 11.3% or by $54.3 million. The Common Corporate costs are going down because an adjustment to compensation as directed by the OEB in the Transmission Decision, OPEB reductions and an increase in the amounts capitalized as can be seen in the "Other OM&A" line. This has nothing to do with savings generated by HON.

The Council cautions the Board about accepting HON's position that OM&A is "shrinking". HON relies on the fact that the 2018 forecast is $16.3 million below Board approved 2017 numbers. However, we see 5 categories of OM&A costs increasing collectively by 11.3 % if we consider actual 2017 results. Common Corporate Costs and Other are going down by $36 million, not because of productivity, or cost reductions driven by HON, but rather because of mandated reductions related to OPEBs, the OEB's transmission Decision and an increase in the amount capitalized as can be seen within the content of the Other OM&A line. The deduction to OM&A related to capitalization was $110.2 million in 2017 and $135.6 million in 2018 further skewing the overall comparison from 2017 to 2018. When you consider these numbers it is difficult to see how HON's proposed productivity "savings" of $400 million that have been presented at a high level have found their way into the budgets, both capital and OM&A. Furthermore, HON has not included savings associated with the new Vegetation Management program or with respect to the fact that it is in-sourcing its customer care function.

HON is claiming that the move to a three-year cycle for Vegetation Management. Although HON is not seeking approval to increase its budget given the change to a new increased cycle, the Council notes that HON's sustainment budget, of which the Vegetation Management program is a significant component is increasing by $42

million relative to 2017 actuals. The increase in Vegetation Management alone from 2017 actuals to 2018 forecast is $22.7 million.[26]

The Council submits that HON's starting OM&A level for 2018 should be more aligned with the actual amounts for 2016 - $562.6 and 2017 - $558.7. The Council proposes that HON's OM&A level for 2018 be set at $560, which is in line with historical levels. If OM&A is truly "shrinking" this is an appropriate starting point for the 5-year plan. HON indicated during the hearing that it was tracking below its 2018 budget. This is before the adjustment for Compensation, as set out below of $17.5 million, and the elimination of the pension contribution of $37 million, which would further reduce the $560 million.

4. COMPENSATION:

HON's compensation levels have been the subject of each and every HON rate proceeding, both with respect to Transmission and Distribution over the last decade. There is not one OEB Decision that did not express a concern over HON overall compensation costs:

- The Board concludes that it is appropriate to disallow some compensation costs because these costs are substantially above those of other comparable companies and the company has failed to demonstrate that productivity levels offset this situation…The Board will disallow $4 million in each of the test years; this level of adjustment goes some way toward aligning Hydro One's costs with other comparable companies. (May 28, 2008)[27]

- The Board is also concerned that the cost structure of the Company, unless is placed within reasonable boundaries based on appropriate comparisons, will simply continue to rise with successive labour agreements or supply contracts without effective restraint or improvements in efficiency. (December 18, 2018)[28]

- Hydro One did not provide sufficient evidence in support of its proposed compensation spending. The company did not demonstrate that the market

[26] AIC, p. 120.
[27] OEB Decision - EB-2008-0272, p. 30
[28] OEB Decision - EB-2007-0681, p. 13

requires the level of compensation proposed in order to attract and retain the necessary employees. In the absence of such evidence the OEB will use the market median as a reference point for the percentage of compensation costs that will be included in the rate paid by Hydro One's customers…While the OEB recognizes that the progress Hydro One has made over the last few years in getting closer to the market median, the OEB does not find that it is fair that ratepayers pay for a 10% premium over the market median. (March 12, 2015)[29]

- The OEB finds that the significant increases in compensation levels for senior executives and for members of the Board of Directors that Hydro One Limited has introduced have not been justified for recovery in OEB regulated rates for transmission services. The OEB is also concerned that Hydro One's progress towards bringing its total compensation levels down to the market median has now reversed…Accordingly, for ratemaking purposes the OM&A envelopes will be reduced by $15 million each year to $397.7 million for 2017 and $394.3 million for 2018 to reflect the unreasonable levels of compensation sought to be recovered from ratepayers. (October 11, 2017)[30]

HON filed seven compensation benchmarking reports during the course of this proceeding. It is HON's position that it commissioned all of the studies in order to be better informed of the appropriate compensation levels for talent (with the exception of the Mercer Study which was directed by the OEB).[31]

On April 20, 2018, HON filed an updated Mercer Compensation study. Mercer had undertaken studies for HON Transmission and Distribution in each of the following years – 2008, 2011, 2013, 2016 and 2017. The study reflected 3,210 Hydro One employees in 34 benchmark jobs representing 59% of HON's employee population. The updated study concluded that HON is positioned approximately 12% above the market 50th percentile (P50 or median).[32]

HON was positioned at 10% above market median in previous years, but by 2016 it was at 14% above market median. The Council notes that the study excludes the

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[29] OEB Decision – EB-2013-0416, p. 24
[30] OEB Decision – EB-2016-0160, pp. 58-59
[31] Tr. Vol. 3, p. 10
[32] Ex. CC/T2/S1 Attachment 5

share grant, although ratepayers are funding that benefit. We can assume if the share grant program is included HON's story gets even worse. The cost of the share grant program is included in the revenue requirement.[33]

The updated Mercer total compensation study that was filed on April 20, 2017, shows that HON has moved from being 14% above P50 or the market median to 12 %. In 2013 HON's compensation was at 10% above the market median. So, since 2015 HON has, on average had compensation levels that are higher than what it had in 2013. HON has admitted that the biggest factor is related to pension and benefits. During the oral hearing HON's witness stated, that Hydro One has "much more generous" pensions and benefits than other employers[34].

HON has not justified why, as a company it is required to pay its employees compensation above the market median. HON seems unable to control its labour costs despite repeated direction from the OEB to do so.

HON has provided an analysis that sets out the dollar difference between the weighted average total compensation for HON's employees allocated to its Distribution business and the P50/median used in the Mercer Compensation Study. That difference is $37.8 million, with $17.5 million related to OM&A and $20.3 million related to Capital[35]. The Council submits that the OEB should disallow the full amount. This relates to both the OM& and Capital portion of the revenue requirement. As stated earlier, if HON chooses to continue to support compensation for its employees that are significantly above the market, the shareholders should be required to fund that premium. The Council hopes that going forward HON will strive to be better aligned with comparator companies.

Pension Contributions:

With repsect to pensions, the evidence in this case is that HON's pension plan is in a surplus position[36]. The current surplus is more than $434 million.[37] HON is

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[33] Tr. Vol. 3, p. 187
[34] Tr. Vol. 3, pp. 179-180
[35] Ex. I 40-SEC-83
[36] Tr. Vol. 3, p. 30
[37] Ex. C/T2/S2/Attachment 1/Section1.2

seeking to recover $37 million from ratepayers in 2018.[38] During the hearing HON confirmed these amounts. With respect to a contribution holiday HON's witness referred to new pension rules that have "come into play" that are effective in 2018 that may limit the ability to take a funding holiday. He also stated that, "To the extent that we could take a contribution holiday, I think we would definitely entertain that idea."[39]

The Council agrees with the submissions made by Board Staff on this issue. The revenue requirement should be reduced by $37 million to reflect the fact that HON is not required to make a contribution in 2018. Under the new rules, if HON is restricted from taking a contribution holiday, the differences can be recorded in the existing pension variance account.

5. ACQUIRED UTILITIES:

Since HON's last rebasing it has acquired three distribution companies. Norfolk Power Inc., Haldimand Country Hydro Inc. and Woodstock Hydro Services Inc. (collectively, the Acquired Utilities). The Acquired Utilities are fully integrated with the operations of the HON.[40] In each of the proceedings where HON was seeking approval to acquire these utilities the OEB determined that the customers should be charged rates that reflect the cost to serve them. For 2021 the incremental revenue requirement associated with serving the Acquired Utilities' customers is $25.6 million.[41] It is HON's position that the revenue that would need to be collected from the acquired utilities customers had they not been acquired would be $39.9 million.[42] This was derived by using the average rate adjustments experienced by the other Ontario utilities that rebased over the 2015-2017 period.

The rates for each of the acquired utility customers were frozen for a period of five years with a 1% decrease in the rate that applied that was credited through a rate rider. The rate rider for Norfolk expires on September 7, 2019. The rate riders for Haldimand and Woodstock expire in 2020.

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[38] Ex. C/T2/S2/Table 1
[39] Tr. Vol. 3, pp. 30-31
[40] Ex. A/T7/S1/p. 1
[41] I-56-SEC-96
[42] AIC, p. 150

HON's proposal is to move the acquired customers to their new rate classes on January 1, 2021. HON will create the new 6 rate classes and allocate specific costs to those classes. HON will then apply the OEB cost allocation methodology (CAM) to allocate HON's total costs to all rate classes in 2021 including the new 6 rate classes. HON developed three adjustment factors that are included in the 2021 CAM to ensure that the costs allocated to the new customers appropriately reflect the cost to serve the customers in these classes.[43]

It is HON's position that comparing the total bill impact for the newly acquired customers is less than it would be had they not been acquired.[44] However, HON had admitted that the total costs allocated to those classes is $42.7 million,[45] which includes the incremental costs and a portion of HON's common costs. They are charging those customers $34.9 million because their revenue to cost ratios are below 1.0[46]. In HON's original filing, the allocated cost was $46.2 million, but this changed in the update to reflect a different treatment of distribution stations[47].

The OEB's no harm test regarding consolidation states,

> To demonstrate no harm, applicants must show there is a reasonable expectation based on the underlying cost structures that the cost to serve the acquired customers following a consolidation will be no higher than they otherwise would have been.
>
> While the rate implications to all customers will be considered for an acquisition, the primary consideration will be the expected impact on customers of the acquired utilities.[48]

The Council submits that given the evidence in this case, it is not clear that these transactions would have passed the no harm test. The stand-alone costs are less than the allocated costs. It is only because the acquired customers have low

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[43] Ex. G1/T3/S1/p. 5
[44] Tr. Vol. 10. p. 83
[45] Tr. Vol. 10, p. 122
[46] Tr. Vol. 10, p. 122
[47] Tr. Vol. 11, p. 15
[48] Handbook, pp. 6-7

revenue to cost ratios that the costs they are paying in rates are less than their stand-alone costs. In effect, they are not paying the full costs to serve them.

The Council has a number of concerns with HON's proposals regarding the acquired utilities:

- The OEB has been explicit about what constitutes "no harm". There must be a reasonable expectation that the costs to serve the acquired customers following a consolidation will be no higher than they would have otherwise been. In this case, that is not true and the variance would have been larger based on the numbers in the original filing ($46 million vs $39 million). It is not entirely clear from the evidence why HON changed the allocation from its original evidence to it current proposal. HON indicated that it was because of concerns raised in the Technical Conference, but it may have been to address the concerns raised by the OEB in the Orillia Decision;

- Because the R/C ratios for the acquired customer classes are low, the acquired customers are not paying for all of their allocated costs and are being subsidized by the other HON customers including those that were previously acquired by HON. It is HON's position that once the R/C ratios are within the range, it is acceptable cross subsidization;[49]

- It may be appropriate to adjust the R/C ratios in order to reduce the cross–subsidies, but this will also create a greater gap between what the acquired utilities would pay relative to the stand-alone scenario;

- In the past, the customers of the acquired utilities were rolled into HON's existing rate classes and required to pay the costs allocated to those classes. In this case HON is taking a different approach. It is creating separate rate classes and does not intend to eventually harmonize all of the rates. There will be different treatment for like customers of HON depending upon when an acquisition occurred;

[49] Tr. Vol. 10, p. 154

- The treatment of the acquired customers, which may not be appropriate, and unfair to HON's other customers may form a precedent for all other future acquisitions;

- It is not clear as to whether the OEB is more concerned with underlying cost structures, or the rates that are derived though the ultimate cost allocation and rate design process. Revenue to cost ratios can change over time, ultimately impacting how much of the allocated costs are recovered from customers;

- HON told the Board when it bought the Acquired Utilities that the costs to serve them would be less than if they remained stand alone utilities[50], but the evidence is to the contrary in this case; and

- Given the fact that the costs allocated to the Acquired Utilities are higher than the stand-alone scenario could well mean that HON should not be permitted to acquire any utilities in the future unless they provide strong evidence that demonstrates the costs to serve new customers will go down. The Council is of the view this is consistent with the OEB's intent as articulated in its merger policies.

The Council does not support HON's current proposal to establish new rate classes for the Acquired Utilities and undertake cost allocation and rate design practices that differ significantly from the way rates are established for all of the other HON customers. The OEB should direct HON to retain an independent consultant to undertake a study that considers options for setting rates for the customers of any newly acquired utilities. Establishing fairness and equity for all of HON's customers should be the primary objective of the study. The Council is of the view that this is a practical approach given HON does not intend to incorporate the new customers into HON rate classes until 2021.

In addition, the Council is of the view that the OEB should initiate a consultation process regarding its policies around mergers and acquisitions. In recent years there has been a great deal of confusion about these policies and the expectations of the OEB. This was the case in the Alectra Inc. merger proceeding. It was also the

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[50] Tr. Vol. 10, p. 191

case in the more recent natural gas merger application by Union Gas Limited and Enbridge Gas Distribution Inc. In that case there was big debate about whether the policy applied to natural gas utilities. There were also debates about how the "no harm test" should be applied. The OEB's consideration of HON's acquisition of Orillia Power Inc. is still unresolved. The Council believes it is imperative that the OEB review and refine its policy, through a stakeholder consultation process, in order to avoid ongoing debates and contentious proceedings about how it should be interpreted and applied.

6. DEFERRAL AND VARIANCE ACCOUNTS:

The Council has no issues with respect to HON's proposals to establish new accounts or eliminate its existing accounts with one exception. HON is seeking to establish a Lost Revenue Adjustment Mechanism Variance Account to seek recovery of lost revenues related to the incremental savings in 2018, 2019 and 2020 from programs implemented in the 2017-2020 period[51]. The Council has reviewed the submissions of the Vulnerable Energy Consumers Coalition (VECC) regarding the establishment of the Variance Account. VECC has argued against the establishment of the LRAMVA on the basis that HON is unable to provide the necessary information regarding program savings consistent with its load forecast. The Council supports VECC submissions.

7. LOAD FORECAST:

HON's most up to date load forecast was provided in I-46-Staff-219. HON updated the forecast to reflect the 2017 weather normalized consumption and the 2017 number of customers.[52] HON is proposing to update the forecast for 2021 and 2022 as part of the part of its annual filing in 2020. The rationale for the update is to more accurately and fairly allocate the costs to the newly acquired utilities when their new rate classes are established for the 2021 rate year. The Council does not have any issues with the proposed load forecast with one exception. HON should not be permitted to reset the load forecast for the years 2020 and 2021.

8. SPECIAL SERVICE CHARGES:

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[51] Ex. JT3.18
[52] Tr. Vo. 10, p. 81

In the last distribution case HON was directed by the OEB to undertake a study assessing whether its service charges reflect HON;s underlying costs and to propose any changes to mitigate any under-recovery of costs. HON completed a study reviewed by Elenchus Research Associates Inc. to assess its special service charges and the level of those charges[53]. Initially the Council had significant concerns with HON's proposals to increase its special service charges because of the outcome of the Elenchus Study. The evidence was that many of HON's Service Charges were increasing significantly and customers had not been consulted about these changes or informed about the fact they were increasing. At the oral hearing HON indicated that many of the charges would be either eliminated or maintained at the current levels[54]. The Council supports HON's proposals to change those fees or eliminate them as described during the oral hearing process.

The Council remains concerned that HON is significant increasing the charges for certain services without any notice to customers. For example, a Service Call regarding customer-owned equipment (Rate Code 25) is going from $30 to $210. A disconnection/reconnection at the pole (Rate Code 22) is going from $185 to $230.

OEB Staff has asked for an update regarding the specific service charges. The Council agrees that given the new oral evidence on the last day of the hearing an update on what is being proposed with respect to all of the charges is appropriate. The Council is of the view that HON should only be permitted to phase in those charges that are increasingly significantly and be required to undertake customer engagement regarding those changes before they are approved. It is premature at this time for the OEB to approve them.

9. SEASONAL RATES:

HON applied for approval of rates for the period 2015-2019 under a Custom IRM approach in 2014. One of the issues raised during that hearing was whether it was appropriate to continue to maintain HON's Seasonal rate classes. The Balsam Lake Coalition raised a number of concerns regarding density and whether there was merit in continuing with Seasonal rates, which are based on eligibility criteria that are arcane. The OEB determined in that case that the Seasonal rate class should be eliminated. In its Decision dated March 12, 2015, the OEB directed HON to bring

[53] Ex. H1/T2/S3
[54] Tr. Vol. 11, pp. 6-7

forward a plan for the elimination of the Seasonal class and determined that it would conduct a hearing to examine the rate mitigation issues in the plan with the intent to implement the initial changes January 1, 2016. HON was directed to submit its plan by August 4, 2015. HON did that. Subsequent to that the OEB initiated a proceeding to consider the next steps for the elimination of the Seasonal class. The OEB required an update Report from HON on the elimination of the Seasonal Class. The OEB also declared rates interim[55].

HON has indicated that it is awaiting further guidance from the OEB on the elimination of Seasonal rates. The Board has made the decision to eliminate the Seasonal Classes, but the timing of the elimination is not clear. The Council submits that in its Decision in this proceeding the Board should clarify its intent with respect to Seasonal Rates. The OEB cannot simply ignore its previous Decisions regarding this issue. The Council recognizes that there could be significant bill impacts for some of HON's customers with the elimination of the Seasonal classes. However, this is not an appropriate reason to simply ignore an earlier Decision. There are tools and creative solutions to deal with customer bill impacts. The OEB has initiated a proceeding to deal with the Seasonal class elimination and the Council believes that it should move forward as soon as possible. The Council believes it is time to correct a system that was created decades ago, which is not based on sound cost causality principles. The inequities in that rate regime should be corrected.

10. EFFECTIVE DATE:

HON filed its application on March 31, 2017. HON held community meetings throughout the summer of 2017 regarding its Application. On August 30, 2017, Procedural Order No 1 was issued, setting out a timeline for Board Staff to file a report on the community meetings and parties to make submissions on a proposed Issues List. It was not until December 1, 2017 that further procedural dates were established for the proceeding including the filing of interrogatories. There was no reason given for the delay in the process. The oral hearing began on June 11, 2018, 14 months after the original Application was filed.

HON is proposing an effective date of January 1, 2018. It is possible that rates will not be determined until Q1, 2019, following the Decision and the establishment of a

[55] Notice and Procedural Order No. 1, dated November 10, 2016 – EB-2016-0315

final rate order. During the oral hearing HON stated with respect to the collection of the foregone revenue (which is calculated assuming rates were in place January 1, 2018) the following:

> We will then look at what the customer bill impacts are resulting from the Board's decision and approved revenue requirement and we'll look at the impact of collecting the foregone revenue over a one-year period, as would typically be done. Hydro One will then ensure that the customer bill impacts are within the guidelines provided in the Board's filing requirements and, if necessary, propose bill impact mitigation which could include extending the recovery period of the foregone revenue[56].

It is HON's plan to collect the foregone revenue over a one-year period subject to an assessment of the overall bill impacts. In the interrogatory process HON estimated that the foregone revenue would be approximately $91 million. If collected over a one-year period. This would represent an average increase in rates of 6.4%.[57] Recovering the shortfall over two-years would represent a 3.2% increase.

The Council is very concerned about what could potentially be a significant impact on rates arising from the collection of foregone revenue. At some point it becomes too late to collect foregone revenue. In this case HON will be going to its customers, potentially in mid-2019 to collect revenues based on an assumption that rates were in place January 1, 2018. They will in effect be saying to their customers – "Your rates are going up not only because of a change in 2019, but they are also going up because we need to collect from you more money related to your service in 2018". From the Council's perspective this is not fair. Customers were not given notice that this may happen. Regardless of the reasons for the procedural delays, HON's customers should not be subject to a retroactive adjustment that goes back more than a year. The Council supports an effective date and implementation date of January 1, 2019.

OTHER ISSUES:

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[56] Tr. Vol. 10, p. 85
[57] Ex. I 57-EP-70

HON has made it clear that this evidence and the underlying rates do not reflect the transmission decision regarding taxes which has been the subject of a motion to review and vary.[58] Depending upon the outcome of that motion there could be significant implications on the revenue requirement proposed in this proceeding. That will have to considered by the OEB in its Decision, and HON should be required to file an update to the evidence to incorporate the potential impact on taxes.

D. COSTS:

The Council requests that it be granted its reasonably incurred costs associated with its participation in this proceeding. The Council has worked extensively with other intervenors in order to avoid duplication.

All of which is respectfully submitted

August 10, 2018

[58] Tr. Vol. 2, p. 18