Scott Pollock
T 613.787.3541
spollock@blg.com

Borden Ladner Gervais LLP
World Exchange Plaza
100 Queen St, Suite 1300
Ottawa, ON, Canada K1P 1J9
T 613.237.5160
F 613.230.8842
blg.com

Borden Ladner Gervais

Our File # 339583-000244

By electronic filing

August 10, 2018

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

Dear Ms. Walli

Re: Hydro One Networks Inc. ("Hydro One")
2018-2022 Distribution Custom IR Application
Board File #: EB-2017-0049

Please find attached the Submissions of Canadian Manufacturers & Exporters ("CME") in the above-noted proceeding.

Yours very truly

Borden Ladner Gervais LLP

Scott Pollock

enclosure

c. Erin Henderson and Anne-Marie Reilly (Hydro One)
Gordon Nettleton and George Vegh (McCarthy Tetrault LLP)
EB-2017-0049 Intervenors
Alex Greco (CME)

OTT01: 9138875: v1

EB-2017-0049

ONTARIO ENERGY BOARD

Hydro One Networks Inc.

Application for Electricity Distribution Rates Beginning
January 1, 2018 Until December 31, 2022

SUBMISSIONS OF
CANADIAN MANUFACTURERS & EXPORTERS ("CME")

August 10, 2018

Randy Aiken
Aiken & Associates
578 McNaughton Ave. West
Chatham, ON N7L 4J6

Consultant to CME

Emma Blanchard
Erin Durant
Scott Pollock
Borden Ladner Gervais LLP
World Exchange Plaza
100 Queen Street, Suite 1300
Ottawa, ON K1P 1J9

Counsel to CME

TABLE OF CONTENTS

1.0 INTRODUCTION

1. These submissions are made on behalf of Canadian Manufacturers & Exporters ("**CME**").

2. CME's members, which include over 1,400 Ontario based companies that operate energy intensive businesses. Their continued competitiveness in their respective industries is tied directly to energy costs and, as a result, the dramatically increasing cost of energy in Ontario has made it much more difficult for CME members to be competitive in the market, compared with businesses in other jurisdictions where energy costs less.

3. Hydro One Networks Inc. ("**HONI**") has proposed a rate-setting framework for the five year period commencing January 1, 2018. It requests approval for revenue requirements of $1,514.2 million in 2018, $1,561.0 million in 2019, $1,607.4 million in 2020, $1,681 million in 2021 and $1,722.24 million.[1] The approximately two-hundred million dollar increase to HONI's revenue requirement over the plan period will drive increased energy rates for CME's members across the province.

4. In preparing these submissions, CME has benefitted from reviewing the submissions of Board Staff. This has assisted CME in making efficient use of resources given the scope of this application.

5. These submissions focus on the components of the Applicant's proposal which, in CME's submission, require adjustment in order to ensure rates in Ontario are just and reasonable, and to protect ratepayers with respect to the cost of electricity distribution. Where these submissions do not touch on an issue that was outlined in the Board's approved issues list, CME takes no position with respect to that issue.

2.0 THE APPLICATION

6. On March 31, 2017, the Applicant filed an application for an order approving just and reasonable rates and other charges for electricity distribution to be effective January 1,

---

[1] Hydro One Networks Inc., Final Argument of Hydro One Networks Inc., July 20, 2018 ("**AIC**"), p. 20.

2018 to December 31, 2022 (the "**Application**") pursuant to section 78 of the *Ontario Energy Board Act, 1998* (the "***OEB Act***").[2]

7. On June 7, 2017, HONI updated the Application in a number of areas, and filed Exhibit Q for the first time, which, *inter alia*, set out HONI's new vegetation management strategy, and provided the related report by Clear Path Utility Solutions LLC.

8. A technical conference was held on March 1, 2, and 5, 2018, and eleven days of oral hearing were held from June 11 to 28, 2018.

9. On July 6, 2018, the Ontario Energy Board ("**OEB**" or the "**Board**") released Procedural Order No. 7, wherein the Board stated that submissions would be due on the following dates: HONI's Argument-in-Chief on July 20, 2018, OEB Staff submissions on August 3, 2018, intervenor submissions on August 10, 2018, and HONI's reply on August 31, 2018.

10. The Application has the following features:

- A revenue cap mechanism to set rates during the 5 year plan period, featuring an I – X formula for increasing rates and a stretch factor of .45% set for all five years of the plan term;
- An earnings sharing mechanism ("**ESM**") that would share any earnings above a 100 basis point dead-band with ratepayers on a 50/50 basis;
- A Z factor with a materiality threshold of $1 million;
- A custom capital or "C" factor, that would escalate rates based on projected revenue requirement impacts resulting from planned increases in rate base during the plan term;
- A Capital In-Service Variance Account that tracks the difference between the revenue requirement associated with actual in-service capital additions during the rate year and the corresponding revenue requirement associated with the OEB-

[2] S.O. 1998, c. 15 Sched B.

approved in-service capital additions. HONI proposes that if their actual cumulative in-service additions are 98% or less of the forecast amounts, the difference will be recorded in the variance account and returned to ratepayers;

- The integration of Norfolk Power Distribution Inc., Haldimand County Hydro Inc. and Woodstock Hydro Services Inc. into HONI's rate structure;
- The beginning of smart meter replacements;
- A proposal for the OEB to approve the construction of an Integrated System Operating Center; and
- A radically different vegetation management strategy.

3.0 CUSTOM APPLICATION

3.1 Inflation and Productivity Factors

3.1.1 Inflation Factor

11. HONI proposes to use an inflation rate that is a weighted sum of 70% of the annual percentage change in Canada's Gross Domestic Product Implicit Price Index Final Domestic Demand (the "**GDP-IPI-FDD**") and 30% of the annual percentage change in the average weekly earnings for workers in Ontario, both as reported by Statistics Canada.

12. This is the same inflation factor as the one established by the OEB for use in incentive rate setting under both price cap IR and annual index plans,[3] and was determined in the OEB's December 2013 Report *"Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors"*.[4]

13. HONI also proposes to update the inflation factor annually for 2019 through 2022.

14. CME submits that both of these proposals are appropriate under the circumstances. There has been no evidence provided in this proceeding of a more appropriate inflation factor,

---

3 EB-2017-0049, Exhibit A, Tab 3, Schedule 2, p. 3.
4 EB-2010-0379, Report of the Board, Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors, Issued November 21, 2013, Updated December 4, 2013.

and HONI's proposed inflation factor and the annual update are consistent with OEB practice applicable to other electricity distributors.

3.2 Custom Productivity Factor

15. With respect to the proposed custom productivity factor, while CME submits that the proposed productivity factor of 0.45% is appropriate, it disagrees with both the need to have a custom productivity stretch factor, and to holding this figure at the same level over the 2019 through 2022 portion of the custom IR term.

16. HONI hired Power Systems Engineering ("**PSE**") to conduct a total factor productivity study for its distribution system and a custom econometric benchmarking study of its total distribution costs. Pacific Economics Group ("**PEG**"), the expert retained by Board staff for this application, supported PSE's recommendations with respect to the productivity factors.

17. PSE's first report, filed with HONI's application on March 31, 2017 found that the appropriate stretch factor for HONI was .6%, on the basis that from the years 2013-2015, HONI had costs that were, on average, 26% above benchmark expectations.[5]

18. As part of HONI's June 7, 2017 update, it filed an updated report from PSE. The updated report found that a .45% stretch factor was appropriate. This finding was based on HONI's 2014-2016 cost performance, which showed that HONI's costs were 24.7% above the benchmark expectations.[6] As 25% above the benchmark expectations is the threshold requirement for a .6% stretch factor, HONI argued that a .6% stretch factor was no longer warranted.

19. CME notes that in the OEB's September 14, 2017 letter *Re: Incentive Rate-Setting: 2016 Benchmarking Update for Determination of 2017 Stretch Factor Rankings – Board File*

---

5 EB-2017-0049, Exhibit A, Tab 3, Schedule 2, Attachment 2, filed March 31, 2017, Econometric Benchmarking Study: Total Distribution Costs of Hydro One Network, Power Systems Engineering, March 8, 2017, p. 3.

6 EB-2017-0049, Updated Exhibit A, Tab 3, Schedule 2, Attachment 2, Econometric Benchmarking Study: Total Distribution Costs of Hydro One Network (Updated with 2016 Actual Hydro One Data and Projections to 2022), p. 6.

No. EB-2010-0379 setting out the updated stretch factor assignments, HONI was moved from cohort 5 (with a 0.6% stretch factor) to cohort 4 (with a 0.45% stretch factor).

20. CME agrees with the productivity stretch factor of 0.45%. However, CME does not believe that a study to determine a custom productivity stretch factor was necessary. The OEB should continue to rely on the updated stretch factor assignments based on the rankings from the annual benchmarking exercise undertaken by the OEB each year.

21. This is because the OEB benchmarking exercise takes into account the overall change in productivity of all electric distributors in the province. If a distributor improves its performance, but the overall industry improves its performance by a greater amount, the distributor will actually have fallen behind other distributors. Similarly, a distributor may be outpacing the industry in Ontario with respect to cost effectiveness. This is key in benchmarking.

22. CME is also concerned that not updating the productivity stretch factor on an annual basis would not provide sufficient inventive to ensure that HONI does not slip back into cohort 5, with costs that are 25% or more above benchmark expectations, since such a reduction in productivity would not affect their stretch factor. While this would not be reflected in the rate cap index as proposed by HONI, this would have negative consequences for ratepayers at the end of the IRM term. It could also have negative consequences with respect to the potential for earnings sharing during the IRM term.

23. CME submits that the OEB should direct HONI to update the productivity stretch factor for each year of the IRM term to reflect the results of the annual update of the benchmarking exercise. This ensures that ratepayers benefit if HONI's performance worsens over the 5-year period while providing HONI with higher rate increases if their performance improves over the period. This approach appropriately balances the outcomes for both ratepayers and the company.

24. If the OEB determines that HONI should be allowed to fix the productivity stretch factor at 0.45% for the entire IRM period, then CME submits that there should be an incentive for HONI to improve its cohort ranking in the annual OEB benchmarking update.

25. CME submits that an incentive equal to the materiality threshold ($1 million as proposed by HONI or some other level as approved by the OEB) should be established to incent HONI to improve its cost effectiveness. In particular, HONI would be entitled to collect the incentive at the end of the IRM term if it has improved its ranking from cohort 4 (i.e. moved to cohort 3 or better) by the end of the IRM term. Similarly if HONI moved from cohort 4 back to cohort 5, ratepayers would be entitled to same level of payment at the end of the IRM term.

26. This mechanism would not only provide an incentive for HONI to improve its cost effectiveness, but also an incentive not to allow reduced cost effectiveness. The proposed mechanism also provides a benefit to ratepayers in that if HONI improves its ranking by the end of the IRM term, this will result in lower costs upon rebasing. Similarly, if HONI falls back to cohort 6, ratepayers will receive a credit to compensate them for the decrease in cost effectiveness.

3.3 Custom Capital Factor

27. CME is making submissions on two aspects of the custom capital factor. The first is the inclusion of total working capital in the calculation of the C factor included in the revenue cap index. The second submission is in respect to the operation of the CISVA.

3.3.1 Working Capital and the Calculation of the C Factor

28. According to HONI's evidence, the capital factor employed in the application is designed to ensure:

> ***[T]hat total revenue resulting from the Custom IR is able to meet HONI's specific circumstances arising from the proposed capital investments set out in Hydro One's DSP.***[7]

[7] EB-2017-0049, Exhibit A, Tab 3, Schedule 2, p. 5.

29. Despite the DSP being the justification for a capital factor to exist in the first place, the capital factor is calculated with reference to HONI's total rate base, including working capital.[8]

30. CME submits that this is inappropriate, as the working capital component of rate base is independent of the DSP. The impact of the DSP is reflected only in the net plant component of rate base. The difference in calculation is material, as working capital represents nearly 4% of total rate base.[9]

31. CME submits that the C factor calculation should be based on the revenue requirement components of only the net plant component of rate base. In other words, the return on debt, return on equity and income taxes associated with the working capital allowance component of rate base should not be included in the calculation as they have nothing to do with the capital expenditures and additions that result from the DSP.

32. There is no suggestion that the C factor is required for the growth in the working capital allowance component of rate base. In a scenario where the DSP provided for additional capital expenditures that offset the growth in accumulated depreciation such that the net plant component of rate base remained flat, there should be no need for a C factor. However, assuming growth in the working cash allowance component of rate base to reflect increases in OM&A costs and in the cost of power, HONI's proposed C factor would calculate an incremental increase in rates beyond the traditional I – X component. Such an increase would not be justified.

33. Accordingly, CME submits that the calculation of the C factor should be based on only the DSP related net plant component of rate base and not the working capital component of rate base.

---

8 EB-2017-0049, Exhibit A, Tab 3, Schedule 2, p. 6.
9 EB-2017-0049, Exhibit I, Tab 34, Schedule 34, Staff-181, Table 2.

3.3.2 CISVA

34. With respect to the CISVA account, CME agrees with the HONI proposal with the exception of the use of the 98% factor used in the calculation of the account.

35. In particular, HONI is proposing that the revenue requirement associated with the difference between actual in-service and OEB approved in-service capital additions that are 98% or lower than the OEB approved level would be included in the account for future disposition to ratepayers to reflect that the revenue requirement was too high as a result of in-service additions being lower than forecast.[10]

36. As part of the interrogatory process, HONI indicated that the proposed 2% deadband was chosen because it has minimal impact on customers, while incenting behaviour that better aligns with the outcomes that ratepayers value and is consistent with the OEB's outcomes-based approach under the Renewed Regulatory Framework.[11]

37. CME submits that the OEB should approve a 100% factor, not a 98% factor for the amounts to be recorded in the CISVA. A deadband is not appropriate because it incents behaviour by the distributor that is harmful to ratepayers.

38. For example, the 2% deadband incents HONI to over forecast in-service capital additions. There are no consequences to the distributor of coming in under the budget that is built into rates each year during the IR term, effectively creating a buffer amount in the revenue requirement that can be used to offset other costs such as higher OM&A costs than those included in the approved revenue requirements.

39. With in-service additions averaging around $750 million over the 2018 through 2022 period,[12] the 2% deadband represents about $15 million in capital additions in each year. On a cumulative basis, this represents about $67.5 million in rate base by 2022, taking

---

10 EB-2017-0049, Exhibit A, Tab 3, Schedule 2, p. 10.
11 EB-2017-0049, Exhibit I, Tab 17, Schedule EnergyProbe-14, p. 2.
12 EB-2017-0049, Exhibit D1, Tab 1, Schedule 1, Table 4.

into consideration the half-year rule for 2022 additions. A rough estimate of the impact on the revenue requirement in 2022 alone is in the range of $6 to $7 million.

40. The OEB's *Handbook to Utility Rate Applications* dated October 13, 2016 (the "**Rate Handbook**") indicates that under the Custom IR methodology, rates are set for 5 years considering a five-year forecast of the utility's costs and sales volumes and is intended to be customized to the fit the specific utility's circumstances. CME submits that if HONI believes that a 2% deadband in the CISVA is appropriate, then HONI has not adequately factored this into its five-year forecast. The CISVA proposal could be used to provide protection to HONI when it comes in at the level it expects it can achieve, which is lower than the OEB approved level of capital additions that it has proposed.

41. CME submits that the OEB should not approve a factor of less than 100%. The starting point for any entries in the CISVA should be the OEB approved level of in-service capital additions, not some fraction thereof.

3.4 HONI's Program-Based Cost, Productivity and Benchmarking Studies

42. HONI filed a number of program-based benchmarking studies undertaken by different consultants, including studies relating to vegetation management as well as pole replacement and station refurbishment. While CME will have further submissions regarding those studies in the sections dealing with their respective subject matters, CME submits that the OEB should require HONI to report on each of the areas covered by these studies (vegetation management, pole replacement and station refurbishment, and information technology) at the end of the IRM term to determine if the projected outcomes of incorporating the results of these studies into its work programs have been realized.

3.5 Integration of the Acquired Utilities

43. CME submits that there is no need to update the cost of capital parameters and load forecast for 2021, nor is there any reason why the cost allocation model should be updated in order to establish rates for the Acquired Utilities, as proposed by HONI.

44. Moreover, CME submits that this is a clear deviation from the Rate Handbook and causes an issue with respect to double counting changes in the inflation rate with changes in interest rates.

3.5.1 Is There a Need for an Update?

45. HONI states that its 2021 application would seek a number of adjustments, including:

(a) an updated load forecast along with the resulting billing determinants for 2021 and 2022;

(b) An update to the 2021 and 2022 capital factors based on the OEB's 2021 cost of capital parameters; and

(c) File an updated 2021 cost allocation model reflecting the changes above and that makes any necessary adjustments to the proposed rate design that arise (e.g. revenue-to-cost ratios).[13]

46. Each of these adjustments is addressed below.

3.5.1.1 Updated load forecast along with the resulting billing determinants for 2021 and 2022

47. CME submits that HONI has already provided a load forecast, a customer forecast and the associated billing determinant forecast for the entire 2018 through 2022 period, including the Acquired Utilities. There is no need for an update to this discrete item during the Custom IR term.

3.5.1.2 Update to the 2021 and 2022 capital factors based on the OEB's 2021 cost of capital parameters

48. CME submits that the cost of capital does not need to be updated for the Acquired Utilities. The impact On HONI is likely to be *de minimis*.

49. According to HONI's response to Undertaking J2.2, the total revenue requirement associated with the Acquired Utilities is $25.6 million.[14] Reducing this amount by the

[13] EB-2017-0049, Exhibit I, Tab 13, Schedule CCC-15, p. 1.
[14] EB-2017-0049, Exhibit J2.2, p. 1.

OM&A component of $10.7 million leaves a capital related revenue requirement of $14.9 million. Given that HONI's evidence is that the revenue requirements for the 2018 through 2022 Custom IR period are $1,514.2, $1,561.0, $1,607.4, $1,681.0 and $1,722.4 million respectively,[15] the capital related revenue requirement represents less than 1% of the overall HONI revenue requirement.

50. Moreover, the changes in the cost of capital would likely be small. While the Acquired Utilities rebased in 2011,[16] 2012,[17] and 2014,[18] the cost of capital parameters have not varied significantly over this period. In particular, the return on equity built into the Acquired Utilities rates varied between 9.12% and 9.58%.

51. Depending on what the return on equity is determined to be by the OEB for 2021, it is likely that there may be a combination of increases and decreases for the Acquired Utilities. Adding this offsetting impact on the change in the cost of capital on top of the small impact on the overall revenue requirement of HONI of the capital related component of the Acquired Utilities shows how insignificant the impact would likely be.

52. However, if the OEB determines that an update to the cost of capital for 2021 is appropriate and necessary for the integration of the Acquired Utilities, then CME submits that the cost of capital should be updated for the Acquired Utilities to reflect the return on equity and cost of short-term debt used by HONI for 2018 and HONI's forecasted long-term debt rate for 2018.

53. This would put all the HONI customers, both legacy customers served by existing rates and customers of the Acquired Utilities that will be served under the new proposed rates, on an equal footing and would not require an update to the cost of capital parameters for any customers for 2021.

---

15 EB-2017-0049, Exhibit J1.10, p. 1.
16 Woodstock Hydro Services Inc. in Board file EB-2010-0145.
17 Norfolk Power Distribution Inc. in Board file EB-2011-0272.
18 Haldimand County Hydro Inc. in Board file EB-2013-0134.

54. CME notes that HONI only proposes to adjust the return on equity component of the cost of capital for 2021 and it would stay at that level for 2022.[19] However, in their Argument-in-Chief, HONI indicates that the update would be for the return on equity and the short-term debt rate.[20] Based on this evidence there does not appear to be any update for 2021 related to the long-term debt rate.

55. The only rationale provided by HONI for the need to update the cost of capital parameters in 2021 is that the cost of capital was last determined in 2011 for Woodstock, 2012 for Norfolk and 2014 for Haldimand and that updating the cost of capital costs is appropriate to reflect and allocate their costs when they are added to HONI's rate base in 2021.[21]

56. CME submits that this does not justify an update to the cost of capital parameters to those determined by the OEB for 2021 rates. HONI's concern regarding the length of time since the cost of capital has been updated could be addressed by using the cost of capital parameters that exist today and are being used for 2018 through 2020 in the updated application, which apply to HONI's existing customers. In fact, according to HONI, that is what they have already done in their 2021 cost allocation exercise to incorporate the Acquired Utilities.[22]

3.5.1.3 The updated 2021 cost allocation model and the proposed rate design

57. CME submits that any changes in the load forecast, customer forecast, billing determinant forecast and the cost of capital are likely to be small, and the impact on cost allocation is likely to be small as well. Furthermore, any changes in the allocation of costs will only make a difference if the revenue to cost ratios are maintained. Changes in the allocation of costs can be superseded by simply changing revenue to cost ratios and keeping rates unchanged from those that would be in place had the 2020 update not taken place.

---

19 Transcript Vol. 2, p. 78.
20 AIC, p. 35.
21 EB-2017-0049, Exhibit I, Tab 7, Schedule CME-1, p. 1.
22 Transcript Vol. 2, p. 82.

58. According to their evidence, HONI is only proposing a partial update to the information used in the cost allocation, since the company is not proposing to update the OM&A or capital factors for 2021.[23] In other words, the cost allocation model would be updated for new load forecasts and billing determinants and a new cost of capital but would not reflect an updated forecast of OM&A expenses or capital expenditures.

59. CME submits that cost allocation is a zero-sum exercise. It does not change the costs, it only allocates the costs. Partial updates to a cost allocation model are inherently unfair to some customers. It re-allocates costs based on an incomplete analysis that moves costs from one group of customers to another. A complete analysis could have a significantly different outcome. Accordingly, HONI's proposed partial update to their cost allocation is inappropriate under the circumstances.

3.5.2 Rate Handbook

60. The Board's Rate Handbook is quite clear with respect to updates once rates have been set as a part of the Custom IR application:

> ***... the OEB expects there to be no further rate applications for annual updates within the five-year term, unless there are exceptional circumstances, with the exception of the clearance of established deferral and variance accounts. For example, the OEB does not expect to address annual rate applications for updates for cost of capital, working capital allowance or sales volumes.***[24]

61. HONI states that the implementation of the new rate classes for the customers in the Acquired Utilities is an exceptional circumstance.[25] CME disagrees.

62. HONI has all the information it needs now to set rates for these new rate classes based on the same forecasts that are being used to set rates for all of HONI's existing rate classes. This includes the load and customer forecast, as well as the billing determinants forecast, the cost of capital, capital expenditures, as well as rate base and OM&A.

---

23 Transcript Vol. 2, p. 81.
24 Rate Handbook, October 13, 2016, p. 26.
25 Transcript Vol. 2, p. 80.

63. The Rate Handbook goes on to state:

> ***A utility that cannot forecast its needs within the five year term, or does not believe it can operate with this level of uncertainty, should consider whether the Custom IR option is appropriate for its circumstances.***[26]

64. Clearly, HONI must believe that it can operate with the level of uncertainty that is inherent in a five-year term and that it can adequately forecast its needs over this period. They have done exactly that for capital expenditures and OM&A. If this was not the case HONI should not have filed a Custom IR.

65. It is not clear to CME how these forecasts are good enough to set rates for the existing rate classes, but somehow deficient for setting rates for customers of the Acquired Utilities.

66. HONI does not have any issues regarding its ability to forecast for the 5-year Custom IR term. Mr. Andre stated they have confidence in the forecast that they have now,[27] and went on to state that if HONI had the opportunity to update its forecast in a few years then it would be more accurate.[28]

67. However, as noted, HONI only wants to use this opportunity for the load, customer and billing determinant forecast, and the cost of capital. It does not intend on using this opportunity to provide a more accurate forecast of OM&A or capital additions.

68. HONI's evidence demonstrates that the customer, load and billing determinant forecasts were heavily influenced by the last year of actual data (2017).[29] CME submits that the same can be expected as part of the proposed update for 2021. However, no adjustments to rate base are proposed, even though rate base in 2021 will be heavily influenced by what happens in 2018 through 2020 in terms of what actually gets added to rate base. According, CME submits that there is no consistency in HONI's proposal.

---

26 Rate Handbook, October 13, 2016, p. 27.
27 Transcript Vol. 2, p. 84.
28 Transcript Vol. 2, p. 84.
29 EB-2017-0049, Exhibit Q, Tab 1, Schedule 1.

69. If the OEB had been concerned about the accuracy of forecasts (for all component of the revenue requirement and the load, customer and billing determinants), then CME submits that it would not have clearly articulated in the Rate Handbook that updates during the Custom IR term were only to be considered if there was an exceptional circumstance.

70. Accordingly, CME submits there are no exception circumstances in this case. HONI has provided cost of capital forecasts for the entire Custom IR period. It has also provided customer, load and billing determinant forecasts for the same 5-year period. HONI has done a 2021 cost allocation study that incorporates the new rate classes for the Acquired Utilities. There is nothing that needs to be done for 2021 that has not already been forecast and completed by HONI in this proceeding. The only rationale for their proposal is that the forecasts would be more accurate; however, HONI did not provide any evidence to support this view. Even if they had, the OEB has already discounted the need for updated evidence during a Custom IR term.

3.5.3 Double Counting Interest Rate Impact on Inflation

71. CME also submits that by updating the cost of capital in 2020 for 2021 and 2022 rate making purposes, HONI has proposed to double count a significant component of the inflation factor used in the revenue cap index.

72. Interest rates are used by OEB to determine the return on equity and short-term interest rates as part of the annual calculation of the cost of capital parameters to be used by electricity distributors. An increase in interest rates (long and short term) increases the return on equity and the short-term debt rate. Similarly, decreases in these interest rates decrease the return on equity and the short-term debt rate.

73. Interest rates are simply the cost of borrowing money. A change in interest rates is, in fact, a change in the cost of borrowing money. This is no different than the change in the price of a litre of gasoline changing the cost of fuel. Both changes in costs are reflected in the components of the inflation factor used by the OEB.

74. The GDP-IPI-FDD captures the changes in the economy due to changes in interest costs and fuel costs. The Average Weekly Earnings captures changes in wages that change in reaction to changes in costs in general, including interest rates and fuel costs. In many cases, the changes in wages are linked to change in the consumer price index, which like the GDP-IPI-FDD, is influenced by changes such as changes in interest rates.

75. In their Argument-in-Chief, HONI makes this point when they state that the cost of capital is impacted by interest rates, which are influenced by macroeconomic conditions.[30] CME submits that these same macroeconomic conditions impact the level of inflation in the economy. The impact of the macroeconomic conditions cannot be reflected through both the inflation factor and the cost of capital in the determination of the revenue requirement.

76. If the OEB were to approve a change in the cost of capital for 2021 and 2022, CME submits that a reduction in the inflation rate used in the revenue cap index for those same years would be required in order to avoid double counting the impact of changes in interest rates. To not do so would not be fair to ratepayers. However, as far as CME is aware, there is no easy way to quantify the double counting. Accordingly, it would be much fairer and simpler not update the cost of capital at all.

3.6 Earnings Sharing Mechanism

77. HONI has proposed an earnings sharing mechanism that would provide ratepayers with 50% of any over-earnings over a 100 basis point deadband above the allowed return on equity. The sharing would be asymmetrical in that if HONI fails to achieve its allowed return on equity there would be no impact on ratepayers. This is the same mechanism as the one that the Board approved in the Toronto Hydro proceeding bearing file number EB-2014-0116.[31]

---

30 AIC, p. 35.
31 AIC, p. 42.

78. CME submits that the OEB should approve the earnings sharing as proposed by HONI, with one exception: the deadband. CME submits that there should be a significantly reduced deadband and that the 50% sharing with ratepayers should apply to all over-earnings above that reduced deadband.

79. Unlike the Toronto Hydro proceeding, which was based on a price cap model, the HONI application is based on a revenue cap index model. Rates are set to recover the forecasted revenue requirement and reflect the load forecast. This is significantly different than a price cap model, where rates are set based on base rates and subsequent increases related to the components of the price cap index.

80. As part of a revenue cap, ratepayers are foregoing the protection and certainty of price that is inherent in a price cap. While under a price cap, ratepayers know the price that they will have to pay for electricity, and can make budgetary decisions based on that. That is not possible with a revenue cap. Asking ratepayers to absorb the uncertainty in the price of electricity distribution, while at the same time permitting the utility to reap all of the benefits of over-earn in relation to their "capped" revenue for the first 100 basis points is, in CME's submission, inappropriate.

81. The proposed deadband of 100 basis points is equal to $30 million in after tax earnings for HONI and more than $40 million on a pre-tax basis.[32] This is 40 times the proposed materiality threshold of HONI and means that ratepayers could pay up to $40 million over and above costs before they see benefit.

82. CME submits that the OEB should provide the same protection to ratepayers as it does to a distributor through the Z-factor and the corresponding criteria of meeting a materiality threshold. Why should HONI be eligible to bring forward a Z-factor cost increase of $1 million, while ratepayers are not provided the same protection with respect to over earning?

---

[32] EB-2017-0049, Exhibit Q, Tab 1, Schedule 1, Table 8.

83. In its evidence, HONI states that:

> ***The challenge inherent in a five-year Custom IR is the need to contend with material, unexpected costs.***[33]

84. CME agrees with this statement, and the need for a Z-factor more generally. However, CME submits that the following statement is equally valid: The challenge inherent in a five-year Custom IR is the need to contend with material, unexpected over-earnings.

85. In the proposed Custom IR, HONI has based its proposed rates on projections of OM&A cost increases and high levels of capital expenditures. The proposed rates recover the revenue requirement. Any material earnings above the revenue requirement are, by definition, the result of something unexpected – lower OM&A increases than forecast, lower capital expenditures than forecast, higher than expected productivity settings, higher than forecast customer additions and/or consumption, or some other factors. In any case, they are, by definition, unexpected; otherwise their impacts would have been included in the Custom IR application

86. CME submits that ratepayers deserve equal protection as the distributor and requires the OEB approve an earnings sharing mechanism that reflects the same materiality threshold that is applicable to the distributor. To do anything else would be biased in favour of the distributor. Why should a distributor be subject to one materiality threshold when it comes to an unexpected increase in costs, while ratepayers are subject to a threshold 40 times larger in magnitude when it comes to the sharing of unexpected earnings in excess of costs?

87. With a deadband equal to the materiality threshold, HONI is still incented to achieve cost savings over the IRM term. It will still retain 50% of all earnings in excess of the materiality threshold above the allowed return on equity.

---

[33] EB-2017-0049, Exhibit A, Tab 2, Schedule 2, p. 11.

3.7 Balances in the Earnings Sharing Deferral Account Should be Cleared Annually

88. HONI proposes to credit the customer share of any over earnings during the term of the Custom IR to a new deferral account for clearance at the time of HONI Distribution's next rebasing.[34] While CME agrees with the need for a new deferral account it does not agree with holding those balances until the next rebasing for three reasons.

89. First, holding the balances to be rebated to ratepayers until HONI's next rebasing application generates unnecessary intergenerational inequity. The customers that would receive the benefits from over earning will not be the same customers the incurred the rates that generated the excess earnings over the term of the Custom IR.

90. Second, there is no certainty around when the next HONI Distribution rebasing application will take place. It may well be deferred for a year or more, as the OEB has seen with the numerous requests by electricity distributors to defer their next rebasing application over the last several years. This only exasperates the intergeneration inequity problem of the proposal.

91. Third, HONI has proposed to review and dispose of Group 1 deferral and variance accounts as part of the annual updates during the Custom IR term.[35] There would not be any issues associated with including the earnings sharing deferral account to this review and disposition.

92. Given the above, CME submits that the earnings sharing deferral account should be cleared annually.

3.8 Z Factors and Off-Ramps

93. CME largely supports the Z-factors and off-ramps as proposed by HONI; however, CME submits that the materiality threshold of $1 million, while consistent with the current OEB policy for distributors with a revenue requirement in excess of $200 million, is too low.

---

34 EB-2017-0049, Exhibit A, Tab 3, Schedule 2, p. 9.
35 EB-2017-0049, Exhibit I, Tab 13, Schedule CCC-15.

94. CME notes that the materiality threshold for a distributor with a revenue requirement of $200 million is equal to 0.5% of this amount, or $1.0 million. HONI's total revenue requirement is in the range of $1,500 to $1,700 million,[36] a range that is approximately 8 times larger than $200 million. This means that the effective materiality threshold for HONI is approximately 0.0625% of its revenue requirement, rather than the 0.5% for the $200 million revenue requirement distributor.

95. It is not reasonable for HONI to have a materiality threshold that is the same magnitude as a distributor that is 1/8th the size of HONI. Accordingly, CME submits that the OEB should use a materiality threshold that is at least $2 million, if not higher.

3.9 Achieved Productivity Savings

96. CME agrees with Board Staff that HONI's approach to quantifying productivity savings achieved has a large component of subjectivity to it, and submits that the Board and parties would benefit from a more well-defined and objective criteria for what constitutes productivity savings. CME further agrees with Board Staff that the Board should direct HONI to more clearly demonstrate how productivity savings achieve objectively quantifiable cost savings for ratepayers in their next rate application.

4.0 DISTRIBUTION SYSTEM PLAN

97. The distribution system plan is a document that consolidates two separate sets of information: the asset management process, including the approach the distributor uses to assess information on assets, operating conditions, and the distributor's business in order to plan and optimize expenditures; as well as the capital expenditure plan, which sets out and justifies the proposed expenditures on the distribution system and (non-system) general plant.[37]

---

36 EB-2017-0049, Exhibit Q, Tab 1, Schedule 1, Table 2.

37 Ontario Energy Board, Filing Requirements for Electricity Transmission and Distribution Applications, Chapter 5: Consolidated Distribution System Plan Filing Requirements, dated March 28, 2013, p. 1.

98. In addition to several discrete submissions that CME makes in response to HONI's distribution system plan, CME submits that downward adjustments to HONI's proposed revenue requirement are needed to address a number of issues that CME submits exist within HONI's application.

99. Reductions are required:

(a) To account for sub-optimal prioritization and possible unnecessary spending due to erroneous or missing data with HONI's Asset Analytics tool;

(b) In order to re-optimize the capital program in light of the significantly improved reliability forecast by HONI's vegetation management strategy, and to align it with customer's needs and preferences;

(c) To account for that fact that HONI has not justified the proposed level of expenditure for distribution station refurbishment;

(d) To provide for more accurate contingency amounts for capital projects;

(e) To bring replacement costs to the mean reflected in Navigant's benchmarking report;[38]

(f) To account for the cost of replacing smart meters that cannot reliably communicate with the network with similarly deficient smart meters; and

(g) To account for the removal of the Integrated System Operating Center until all of the risks are known and allocated.

100. In many instances, the subject matter of this application does not lend itself to specific numerical reductions, for instance, the extent that the proposed capital program should be reduced due to reliability increased derived from HONI's new vegetation management strategy.

101. In their submissions, Board Staff have suggested an 11% reduction to HONI's proposed $3.6 billion 2018-2022 capital program. In this application, there is likely a reasonable

[38] Exhibit B1, Tab 1, Schedule 1, DSP Section 1.6, Attachment 1, p. 14.

range of reductions possible, and CME submits that Board Staff's proposed reduction represents a reasonable floor for the required reductions, but that the issues described below could also justify larger reductions.

4.1 Customer Engagement Process

102. HONI retained IPSOS who produced the "Distribution Customer Engagement Report" dated August 2016 (the "**IPSOS Report**").[39] IPSOS' mandate was "to assist with the design, execution, documentation, and analysis of feedback for the customer engagement and engagement process."[40]

103. CME has two concerns regarding HONI's reliance on the IPSOS report and the customer engagement process. First, HONI's efforts to utilize the IPSOS Report to justify a rate increase is inconsistent with the content and findings of the IPSOS Report. Second, the consultation process itself was flawed, the initial design was not followed by HONI, and concerns from customers regarding a lack of information from customers was not addressed.

4.2 The IPSOS Report Conclusions Do Not Support a Rate Increase

104. HONI relies on four characterizations of IPSOS' findings in their final submissions at pages 65 and 66. CME responds in detail to two of these findings below.

105. With regards to the other findings cited by HONI in their submissions, CME notes briefly that: (a) keeping costs as low as possible is the top priority for residential, small business, and aboriginal customers; [41] that keeping costs as low as possible is also the top priority for large customers (as a group), is particularly important to commercial and industrial customers (discussed further below);[42] and, (c) there is agreement with HONI that the majority of customers told IPSOS their current reliability levels were acceptable.

---

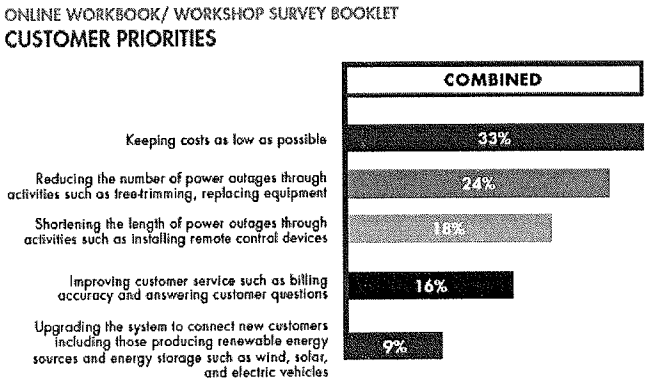
39 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1.
40 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 4.
41 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 16.
42 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 121.

4.2.1 For Large Customers Keeping Costs as Low as Possible is the Top Priority

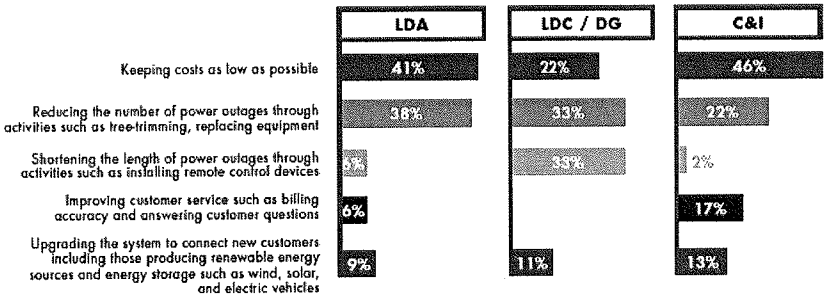
106. HONI states at page 65 of its submissions that:

> ***Regarding large customers, keeping costs low was also a top priority for LDA and C&I customers, although reliability concerns were close second and third priorities. LDC/DGs top priorities were reducing the number and frequency of interruptions, cost was their third priority.***

107. These submissions fail to acknowledge that, when the survey data for all Large Customers is considered, keeping costs as low as possible is the top priority:[43] Large Customers are defined in the IPSOS report as including commercial and industrial, large distribution accounts, local distribution companies and connected distributed generators.[44]



108. For commercial and industrial customers, keeping costs as low as possible is the overwhelming top priority at 46%.[45]



Q3. Hydro One would like to better understand what is important to you as a large customer. From the following list, which would you say is most important to your organization? (select one only) Base: Excludes don't know/refused. LDA (n=34), LDC/DG (n=18), C&I (n=46) Note: the online workbook asked this question in the form of a paired-choice and the analysis was conducted on the combined response (due to smaller base sizes) Base: LDA/LDC/DG/C&I (n=87).

43 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 121.
44 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 6.
45 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 121.

109. HONI states in its submissions that reliability concerns were "close" second and third priorities for commercial and industrial customers. The survey results, excerpted above, show that keeping costs as low as possible was the top priority for 46% of customers – more than double the number of customers who selected the second priority of reducing the number of power outages. Further, the third priority of surveyed commercial and industrial customers related to customer service, not reliability. [46]

110. HONI also ignores in its submissions the results of the facilitated, in person, workshops with Large Customers and the focus on costs during these discussions.

111. On cross-examination, Mr. Brad Griffin, Senior VP, Head of Qualitative Canada, explained in general terms the methodology for reporting on the in person workshops and how conversations from the workshops get included in the IPSOS Report. Not every comment made by a customer is included in the IPSOS Report. Rather, the discussions are organized thematically and only reported on if common themes emerge.[47]

112. A common theme which emerged at these workshops was costs. IPSOS made the following observations during the discussion with Large Customers on costs:

> ***While most customers recognize the need for investments in HONI's aging infrastructure and distribution system, the majority of participants across the Large Customer Workshops do not accept a rate increase of any size, whether reliability remains the same or improves.***[48]
>
> ***For some Large Customers, they stated that the continued rise in electricity prices is a direct threat to the viability and competitiveness of their businesses. It is an expense that is one of or the highest after labour.***[49]

113. The IPSOS Report is clear that cost is the number one priority for commercial and industrial customers.

---

46 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 121.
47 Transcript Vol. 5, pp. 45-46.
48 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 130.
49 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 130.

4.2.2 Consultation Regarding Bill Impacts is Based on Improper Questions

114. HONI states that:

> ***IPSOS also obtained feedback from customers regarding particular bill impacts. For example, a majority of residential and small business customers who provide an opinion would accept a 1.1% monthly bill increase, or $2.00 per month, in order to at least maintain reliability and customer service levels.***[50]

115. CME submits that this result as reported by IPSOS is the product of inappropriate methodology. Specifically the use of questions which were likely to elicit a response in favour of a rate increase.

116. Residential and seasonal customers were asked the following question, which is based on the premise that HONI had already determined that a rate increase was required:[51]

> ***Q17. HONI has determined that in order to at least maintain the level of reliability and customer service it currently provides, a typical [Residential or Seasonal customer's total monthly bill will need to increase by [1.1% or the equivalent of $2.00]. The increase will be applied each year for the next 5 years. By the fifth year, a typical monthly bill will be roughly [IF RESIDENTIAL OR SEASONAL $10.00 / IF BUSINESS: $26.00] higher than it is now. Please note that this increase reflects the cost to maintain the current level of reliability and service to customers. The monthly bill could still increase for other reasons which are outside the control of HONI. Which of the following is closest to your point of view [READ LIST]? Base: All respondents; Residential (n=400), Seasonal (n=100)***

117. The IPSOS witnesses and HONI witnesses were asked about the formulation of this question on cross-examination:

> ***Ms. Durant:*** ***... The language of this question, and in particular "HONI has determined," was that language HONI gave to you, or was this language that you would have assisted HONI with?***
>
> ***Ms. Guiry:*** ***I don't remember in this particular instance whether I drafted that initial wording or HONI did, but we felt that that was an accurate and fair way of articulating the question.***
>
> ***Ms. Durant:*** ***And at this point, and I think I'll address this one to HONI, is it HONI's evidence that as of the time these questions were drafted HONI had already determined***

---

50 AIC, pp. 64-65.
51 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 53.

> ***that these increases were reliable [sic] and necessary?***
>
> ***Mr. Merali:*** ***At the time of the report the investment plan had not been completed, so I don't believe the specific $2 – we didn't have an investment plan corresponded to that.***
>
> ***Ms. Durant:*** ***But in this question the customers are being asked to answer it as if this has been determined.***
>
> ***Mr. Merali:*** ***I believe it was meant to be representative, not specific to the $2, but just demonstrating that increase would likely be required to maintain reliability and gauge customer's responses to that.***
>
> ***Ms. Durant:*** ***And the question doesn't say that it would likely be required; it says that HONI has determined that it is required; is that right, when I read this question?***
>
> ***Mr. Merali:*** ***That is the way the question is worded.***
>
> ***Ms. Durant:*** ***And when customers are answering this question, they have in their mind that it's already been determined?***
>
> ***Mr. Merali:*** ***Yeah, I could see how a customer would come to that conclusion.***[52]

118. Small business customers and Large Customers were asked similar questions, based on the premise that a necessary rate increase had already been "determined".[53]

119. All customers were asked whether or not they disagree with HONI's determination that rate increases were required at certain levels to provide increased, constant or decreased performance. A survey respondent who rejected a rate increase would rejecting a "determination" made by HONI without having information about how that determination was made.

120. These questions are clearly inappropriate and misleading. CME submits that the Board should not rely upon the answers to these questions to conclude that customers of HONI are supportive of a rate increase.

---

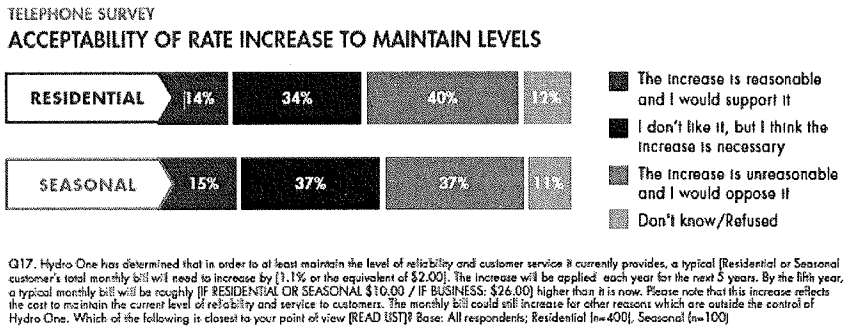
52 Transcript Vol. 5, pp. 61-62.
53 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, pp. 90, 128.

121. Further, it is noteworthy that HONI and IPSOS never presented customers with a scenario that involved no rate increases with reliability and customer service remaining the same.

4.2.3 Survey Results Do Not Support a Rate Increase

122. Notwithstanding the false premise on which the rate increase questions were based, a close look at the IPSOS survey results indicate that many customers nonetheless disagreed with HONI's determination that rate increases were required.

123. The results for residential customers is excerpted below. The largest response to the question was 40% of residential customers who responded that "the increase is unreasonable and I would oppose it."[54]



124. Twelve percent of customers responded "don't know/refused" to this question. It is only when these responses are removed that 55% of residential customers are found to support the rate increase.[55]

125. Given that the question asked respondents to answer this question based on the premise that "HONI has determined" the rate increases were required, it is understandable why survey respondents would refuse to answer the question. These respondents may not have had enough information to answer the question adequately or they may have disagreed with HONI's "determination".

---

54 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 53.
55 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 53.

126. The results for small business customers were similar with 40% of small business customers responding that "the increase is unreasonable and I would oppose it" but with higher numbers of respondents indicating either that the increase is reasonable or that they did not like the increase but that they still felt it was necessary.[56]

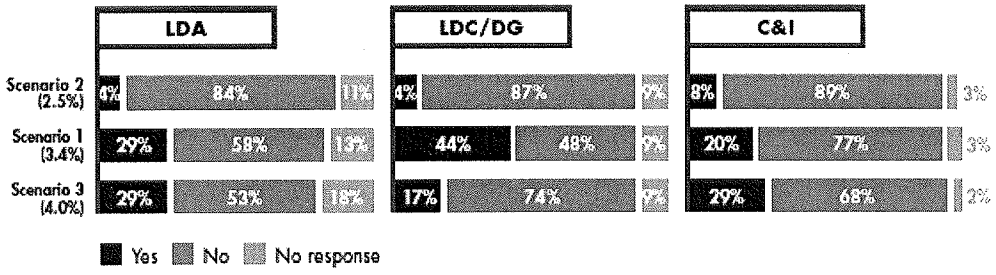
127. At the four discussion groups which were held to "flesh out early learnings and findings from the Telephone Survey",[57] an equal number of small business customers opposed a rate increase. In this regard, IPSOS wrote:

> ***Small Business participants were polarized as to their acceptance of a rate increase. While the majority indicated they don't like the increase but think it is necessary, an equal number stated the increase is unreasonable and that they would oppose it.[58]***

128. HONI's submissions also ignore the survey results with regards to Large Customers and their willingness to support a rate increase for declining reliability and service (Scenario 2), maintained reliability and service (Scenario 1) and improved reliability and service (Scenario 3).[59] The results were as follows, with each of the three rate increase scenarios being rejected by large margins:

ONLINE WORKBOOK/ WORKSHOP SURVEY BOOKLET

WILLINGNESS TO ACCEPT INVESTMENT SCENARIOS



Q15. Would you be willing to accept a 2.5% distribution delivery rate increase where reliability and service performance declines (Scenario 2)? Base: LDA (n=45), LDC/DG (n23), C&I (n= 133) Q16. Would you be willing to accept a 3.4% distribution delivery rate increase where reliability and service performance remains the same as it is now (Scenario 1)? Base: LDA (n=45), LDC/DG (n23), C&I (n= 133). Q17. Would you be willing to accept a 4.0% distribution delivery rate increase where reliability and service performance improves (Scenario 3)? Note that for the online workbook, this was a 4.1% distribution delivery rate increase. Base: LDA (n=45), LDC/DG (n23), C&I (n= 133).

56 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 90.
57 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 100.
58 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 100.
59 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 128.

129. The rationale for the Large Customers' response to these rate increase questions can be informed through the facilitated workshop results. Large Customers inquired in each of the facilitated workshops about efficiencies in operational and maintenance costs and asked for HONI to improve in these areas in order to save money and re-invest in capital expenditures, instead of raising rates.[60]

130. Large Customers expressed frustration regarding the lack of information provided to them regarding operational efficiencies as an alternative option to raising rates:

> ***Rate increases are difficult for many customers to accept as they have serious concerns and numerous questions about HONI's operational efficiency, its ability to effectively manage costs, and its corporate integrity.***
>
> ***Some participants stated that it is difficult to know which scenarios they would accept in the absence of more detailed information.[61]***

131. The workshop materials which can be found in the IPSOS Report provide no information on HONI's operational efficiencies or costs. The workshop materials were based on the premise that a rate increase is required, with no consideration of alternatives.[62]

132. When asked on cross-examination about the lack of information provided to Large Customers about operational and maintenance costs, IPSOS and HONI confirmed that there was no information provided to customers regarding compensation costs and that there was only one slide dedicated to HONI's productivity and efficiency programs.[63]

133. Accordingly, CME submits that the IPSOS report does not support a finding that customers would accept a bill increase to at least maintain reliability and customer service levels.

134. The questions on which this finding is based were based on the false premise that HONI had already determined that there was no alternative but to raise rates. If the determination was already made, the customer engagement process was useless. If the determination

---

60 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 132.
61 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 133.
62 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, beginning at p. 122.
63 Transcript Vol. 5, pp. 46-47. EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, p. 235.

was not already made (which is the evidence of the HONI witnesses), then the results of this survey question were flawed and cannot be relied upon.

4.2.4 Flaws in the Customer Engagement Process

135. CME in its cross-examination of Panel 3 asked a number of questions about the customer engagement process itself, including a review a PowerPoint created by IPSOS titled "Dx Customer Engagement Plan" which was dated May 18, 2016.[64]

136. The Dx Customer Engagement Plan was disclosed in response to an interrogatory requesting a copy of the retainer and/or contract between HONI and IPSOS and a request for the terms of reference and work plan.[65]

137. The Dx Customer Engagement Plan included two phases as is described on page 2 of the Dx Customer Engagement Plan. Phase 1 was to be completed in the summer of 2016.

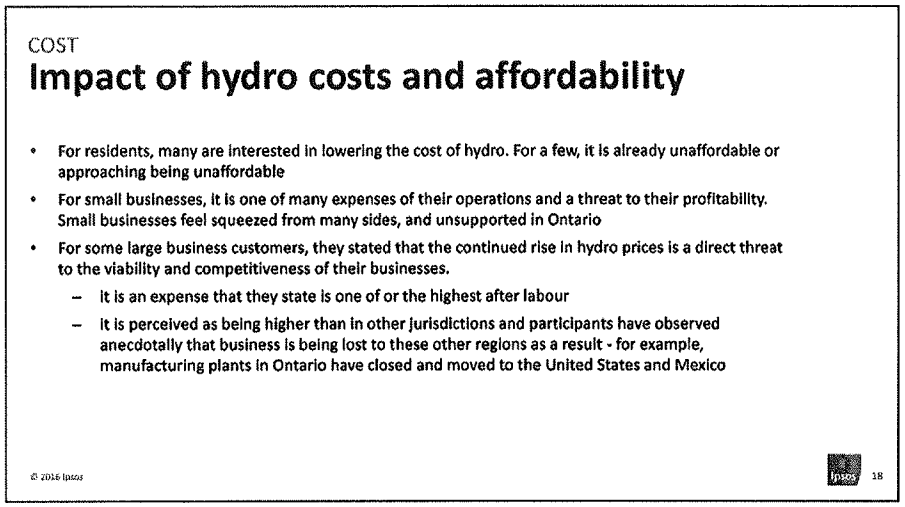
138. Phase 1 resulted in an Interim Report being delivered by July 17 and a final report being delivered on August 10, 2016.[66]

139. The results of the IPSOS Interim Report were shared with HONI's asset management leadership on July 19, 2016.[67]

140. The IPSOS Interim Report highlighted that residential, small business and some large business customers had concerns about costs and affordability:[68]

---

64 CME Compendium Panel 3, Exhibit K5.2, p. 9.
65 EB-2017-0049, Exhibit I, Tab 24, Schedule SEC-35 and EB-2017-0049, Exhibit I, Tab 24, Schedule SEC-35, Attachment 1.
66 CME Compendium Panel 3, Exhibit K5.2, p. 11.
67 EB-2017-0049, Exhibit I, Tab 24, Schedule SEC-36, p. 2.
68 CME Compendium Panel 3, Exhibit K5.2, p. 15.



141. The IPSOS Interim Report also relayed to HONI management concerns that customers had regarding the information provided to them during the consultation process.

142. For example, IPSOS noted that large customers had inquired "repeatedly in all markets" about "efficiencies in operational and maintenance costs" and expressed an interest in seeing further details regarding historical and current efficacy of maintenance programs, and capital expenditures already spent on improvements to help them determine if efficiencies are being achieved.[69]

143. Further, the Interim Report indicated that "All segments expressed a desire for more detailed information as to how the rate increases would be spent so that they can determine if the investments are truly impacting reliability – rather than going to wages, salaries or payouts to HONI employees."[70]

144. No steps were taken by HONI to re-engage with customers despite these concerns regarding the lack of information provided to them during the customer engagement process.[71]

145. The customers' concerns regarding lack of information, however, was noted in the final IPSOS report, as was discussed above.

---

69 CME Compendium Panel 3, Exhibit K5.2, p. 16.
70 CME Compendium Panel 3, Exhibit K5.2, p. 17.
71 EB-2017-0049, Exhibit I, Tab 24, Schedule SEC-36, pp. 1-2.

146. The Dx Customer Engagement Plan also contemplated a Phase 2 which was never completed.

147. Phase 2 of the Dx Customer Engagement Plan was to occur in the winter of 2016 or spring of 2017. Phase 2 would "validate earlier results and to add any new or additional customer insights."[72]

148. Phase 2 was not completed as part of the customer engagement process or the distribution planning process.[73]

149. IPSOS was asked about Phase 2 on cross-examination. The witness responded that she could not recall Phase 2 and that "I think this might be an early draft of the plan. There wasn't much discussion of Phase 2 once we got into Phase 1."[74]

150. CME submits that HONI would have had an opportunity to re-engage with its customers and provide them with additional information that they had requested if they had completed Phase 2 of the customer engagement process. Further, HONI could have used the same opportunity to engage with its customers regarding the Plan B-Modified scenario.

151. CME accordingly submits that HONI's customer engagement process was flawed and inadequate, particularly with regards to the key issue of customers' willingness to accept rate increases.

152. The fact is that customers are not willing to accept rate increases and as a result the increased revenue requirement contained in the Application requires careful scrutiny and should be reduced.

4.3 Data Quality and Completeness

153. CME shares the concern of several other parties that the data that HONI uses to make capital investment decisions may be incomplete or erroneous causing some investments to be in appropriately prioritized over more critical ones and others to be made where none

---

72 EB-2017-0049, Exhibit I, Tab 24, Schedule SEC-35, Attachment 1, p. 2. CME Compendium Panel 3, Exhibit K5.2, p. 36.
73 EB-2017-0049, Exhibit I. Tab 24. Schedule SEC-36.
74 Transcript Vol. 5, p. 64.

are needed at all. CME submits that the Board should reduce HONI's proposed capital program to account for the possibility that missing and erroneous data has caused HONI to inappropriately or incorrectly construct and/or implement their capital spending program.

154. As part of HONI's capital investment planning, the company goes through a multi-stage planning and prioritization process, whereby candidate investments are vetted and ranked.

155. A central component of the capital investment planning process is asset condition data. Since 2012, this data has been aggregated by a planning tool called the "Asset Analytics Tool".[75] The Asset Analytics Tool receives asset related information from HONI's other enterprise software, which includes asset condition data collected during routine maintenance, as well as from performance history, utilization, age and criticality of the assets.[76] The tool is then used by HONI's planners to assess asset needs.[77]

156. The quality and availability of data present in the Asset Analytics Tool therefore has a direct effect on what investments are chosen by HONI to be funded during the plan term.

157. In 2015, the Auditor General of Ontario released a report that was highly critical of the data in the Asset Analytics tool. The report contained two recommendations, #5 and #11, which are relevant to the quality and completeness of HONI's capital investment planning data. Recommendation #5 states, *inter alia,* that to ensure HONI is replacing the assets that are at the highest risk of failure as determined through accurate asset conditions rates, HONI should:

> ***Make changes to its Asset Analytics system and procedures so that updates to its data are complete, timely and accurate; [and]***
>
> ***conduct a comprehensive review of the data quality in Asset Analytics to update any incomplete or erroneous information on its***

---

75 Office of the Auditor General of Ontario, Annual Report, 2015, Chapter 3, Section 3.06, p. 262.
76 SEC Compendium Panel 5, Exhibit K6.2, p. 130. EB-2017-0049, ISD: GP-35, p. 1.
77 SEC Compendium Panel 5, Exhibit K6.2, p. 130.

> ***assets and to ensure the information can support its asset replacement decision making process.***[78]

158. Similarly, recommendation #11 from the Auditor General states:

> ***To ensure that management decisions on replacing distribution system assets are made using reliable and complete information, HONI should take the actions needed to ensure its Asset Analytics system provides timely, reliable, accurate and complete information on the condition of assets.***[79]

159. HONI conducted an internal audit to follow up on the recommendations made by the Auditor General. The draft report was issued on November 25, 2016, and the final report was issued on March 31, 2017, the same day that HONI filed its application in this proceeding (the "**First Internal Audit Report**").[80]

160. The First Internal Audit Report indicated that, as of the time of filing its current application, HONI's response to Recommendation #5 was "partially complete" and "partially effective." The First Internal Audit Report explains that data remediation efforts were primarily focused on transmissions data, but "did not adequately address distribution data integrity issues."[81]

161. The First Internal Audit Report made similar comments with respect to Recommendation #11. While it listed HONI's response as being "substantially complete" and "effective", it states that data remediation efforts have focused on transmission data, and that HONI's effort "had not yet addressed the data quality of distribution data" at the time of the internal audit.[82]

162. HONI also commissioned a second internal audit that was completed on September 6, 2017 (the "**Second Internal Audit Report**"). Asset analytics data was among the items that were assessed in the report.

---

78 Office of the Auditor General of Ontario, Annual Report, *2015*, Chapter 3, Section 3.06, Recommendation #5, p. 263.
79 Office of the Auditor General of Ontario, Annual Report, *2015*, Chapter 3, Section 3.06, Recommendation #11, p. 271.
80 Internal Audit Report: Auditor General Report 2016 Follow-Up, dated March 31, 2017, EB-2017-0049 Exhibit A, Tab 3, Schedule 1, Attachment 3, p. 1.
81 Internal Audit Report: Auditor General Report 2016 Follow-Up, dated March 31, 2017, EB-2017-0049 Exhibit A, Tab 3, Schedule 1, Attachment 3, p. 5.
82 Internal Audit Report: Auditor General Report 2016 Follow-Up, dated March 31, 2017, EB-2017-0049 Exhibit A, Tab 3, Schedule 1, Attachment 3, p. 8.

163. The Second Internal Audit Report found that asset analytics data remained a high risk (unchanged since 2015), and the auditors stated that they remained concerned about the "data quality from supporting systems (such as SAP) that are used as inputs to Asset Analytics".[83] The auditors clearly defined the risk that the data quality issue would have on the capital investment planning process:

> ***The absence of well-understood and quality asset information increases the risk of inadequate asset need assessment which can result in diminished confidence in the process involving the AA tool and the potential for less than optimal investment decisions.***[84]

164. The Auditor General, and HONI's First and Second Internal Audit Reports (collectively, the "**Internal Audit Reports**") therefore touch upon two separate problems with the Assets Analytics tool that persisted during HONI's current investment planning phase for this application: data availability and data quality.

4.3.1 Data Availability

165. The first issue with HONI's Asset Analytics tool is the availability of the data. In their argument-in-chief, HONI states that the focus of both the Auditor General's report as well as the Internal Audit Reports was not on data availability more generally, but whether the data was available within the Asset Analytics Tool itself.[85] As a result, HONI contends that it is simply a matter of the company's planners looking at several sources of information in order to make informed investment choices, rather than having it consolidated into the Asset Analytics Tool.[86]

166. While CME notes that, according its own evidence, HONI is missing large segments of data more generally, including: 11% of data for station transformers; 13% of data for Mobile Unit Substation (Transformers); 16% of data for Station Reclosers; and 62% of

---

83 Internal Audit Report: Investment Planning Follow-up (IPF), dated September 6, 2017, EB-2017-0049, Exhibit JT 3.2, Attachment 2, p. 7.
84 Internal Audit Report: Investment Planning Follow-up (IPF), dated September 6, 2017, EB-2017-0049, Exhibit JT 3.2, Attachment 2, p. 7.
85 AIC, p. 91.
86 AIC, p. 91.

data for circuit breakers,[87] CME submits that not having the appropriate data in the Asset Analytics Tool is, in and of itself, a problem.

167. This problem is recognized by the Second Internal Audit Report. Risk 1.5, labelled "Asset Management Tool Enhancements" outlines the consequences of not providing HONI's planners with the required information in the Asset Analytics Tool itself:

> ***Unavailability of required data in AA [Asset Analytics] & AIP [Asset Investment Planning] tools may result in incorrect/inconsistent decision making. Manual workarounds as a result of lack of data integration could result in delays and/or poor quality investment plans.***[88]

168. CME submits that the lack of data availability in the Asset Analytics Tool also has a direct impact on the company's capital investment plan, leading to unsupported decisions about which assets to replace, and poor quality investment plans.

169. HONI also states that, to the degree that data were to be missing or incomplete, that the result would be that HONI would underestimate the capital spending required by the assets, not overestimate it.[89]

170. CME agrees with Board Staff's submission that, as investment planning is an exercise based on prioritization and rank, that if assets are not replaced because of missing data, other assets could be being replaced earlier than they would have but for the missing data, thereby unnecessarily increasing costs to ratepayers. Accordingly, CME submits that HONI's proposed capital program should be reduced to offset the sub-optimal prioritization of assets that likely has occurred as the result of missing data.

4.3.2 Data Quality

171. CME is also concerned about the data quality represented in the Asset Analytics tool. For instance, the Auditor General found that 14 distribution station power transformers that

---

87 EB-2017-0049, Exhibit JT3.1-11.
88 Internal Audit Report: Investment Planning Follow-up (IPF), dated September 6, 2017, EB-2017-0049, Exhibit JT3.2, Attachment 2, p. 8.
89 AIC, p. 92.

were under 10 years old were mistakenly given age scores of 100 in the Asset Analytics tool.[90]

172. This represents, if anything, a more dangerous issue with the data in HONI's Asset Analytics Tool. Rather than causing sub-optimal prioritization among assets, it may indeed cause unnecessary spending on assets that didn't need to be replaced at all.

173. Given the significant impact that erroneous data such as the inaccurately aged power transformers can have on a capital spending plan, and the fact that the Internal Audit Reports state that not enough has been done to ameliorate the quality of the data at the time that HONI submitted its application,[91] CME submits that the data available through HONI's Asset Analytics Tool is not reliable enough to have any confidence that the capital spending plan is optimized.

174. Accordingly, CME submits that the Board should reduce HONI's proposed capital spending program to account for the sub-optimal planning and the possibility of wasteful spending caused by HONI's data availability and data quality issues.

4.4 Redirection

175. HONI employs a practice that is known as "redirection" whereby the company takes funds originally allocated to certain projects or programs, and 'redirects' them as business conditions change to meet evolving requirements.

176. The use of this practice makes evaluating HONI's past performance, as well as their current application much more difficult, as HONI does not measure redirection on a "project-by-project ... swap basis", but rather HONI meets monthly and internally discusses a variety of factors which impact the budget as a whole.[92] As a result, the Board

---

90 Office of the Auditor General of Ontario, Annual Report, 2015, Chapter 3, Section 3.06, pp. 250-251.

91 The First Internal Audit states that the company's efforts for data remediation did not adequately address distribution data issues: Internal Audit Report: Auditor General Report 2016 Follow-Up, dated March 31, 2017, EB-2017-0049 Exhibit A, Tab 3, Schedule 1, Attachment 3, p. 7. The Second Internal Audit states that it remained concerned with the data quality that are used as inputs to the Assets Analytics Tool: Internal Audit Report: Investment Planning Follow-up (IPF), dated September 6, 2017, EB-2017-0049, Exhibit JT 3.2, Attachment 2, p. 7.

92 Transcript Vol. 9, p. 74.

and parties are simply provided with the discrepancies between the OEB approved amounts and the actual spend, and are left in the dark as to the specific decisions made by HONI to trade off spending in some areas at the expense of other areas.

177. Accordingly, CME supports Board Staff's submission that HONI's use of redirection leads to a number of modifications from what the Board approves, and agrees that the Board should direct HONI, in future applications, to provide:

(a) which projects were completed as shown in the forecast;

(b) actual versus estimated cost of each project at completion;

(c) which projects were deferred or eliminated;

(d) reasons for deferral or elimination;

(e) consequences of each deferral or elimination.[93]

4.5 Vegetation Management Program

178. CME submits that the Board should reduce the revenue requirement associated with HONI's proposed capital program to account for the preferences of ratepayers and to reflect the increased reliability forecast by the company as the result of its new vegetation management program.

179. Over the course of this application, HONI's vegetation management strategy has undergone two significant shifts in focus. Historically, HONI targeted an 8 year vegetation management cycle that but has been unable to achieve it.[94] HONI's original application in these proceedings proposed a more targeted approach for some high-criticality circuits to keep them on a shorter cycle to gain efficiencies.[95] This new proposed cycle would be on a 4 to 8 year cycle,[96] and was dubbed the "hybrid" approach by HONI's witness.[97]

---

93 2018-2022 Electricity Distribution Rates, Hydro One Networks Inc., EB-2017-0049 Ontario Energy Board Staff Submission, August 3, 2018 at p. 75.
94 Transcript Vol. 6, p. 30.
95 Transcript Vol. 7, p. 105.
96 EB-2017-0049, Exhibit Q, Tab 1, Schedule 1, p. 12.
97 Transcript Vol. 7, p. 105.

180. Around the same time that the originally filed vegetation management strategy was being developed, HONI's planners developed three alternative capital spending plans that were presented to their Board of directors. These plans all had different levels of capital spending, and were associated with different outcomes and customer rates over the plan term. Critically, HONI's evidence states that, as a part of developing its capital plans, it assessed, *inter alia*, the reliability impacts of varying investment levels for vegetation management.[98]

181. Plan A, which was the approach favoured by HONI's asset managers, would have seen a rate increase of 7.1% in 2018, with an average rate increase of 3.8% over the term. HONI forecast that this plan would improve reliability of the system.[99]

182. Plan B called for a 6.2% rate increase in 2018, and an average increase of 3.5% over the plan term. Plan B would still have increased reliability, albeit not as significantly as plan A.[100]

183. Plan C minimized the plan rate increase while ensuring HONI was still compliant with regulatory obligations. Plan C would have raised rates by 5.0% in 2018 and 2.8% over the term. This plan was opposed by HONI's planners because of risk to the system.[101]

184. HONI presented the three plans to their board of directors. Despite recommending Plan A, HONI's board rejected all three plans on the basis that Plan A and Plan B would still result in rate increases that were too high for customers. As a result, HONI's planners developed a fourth plan:

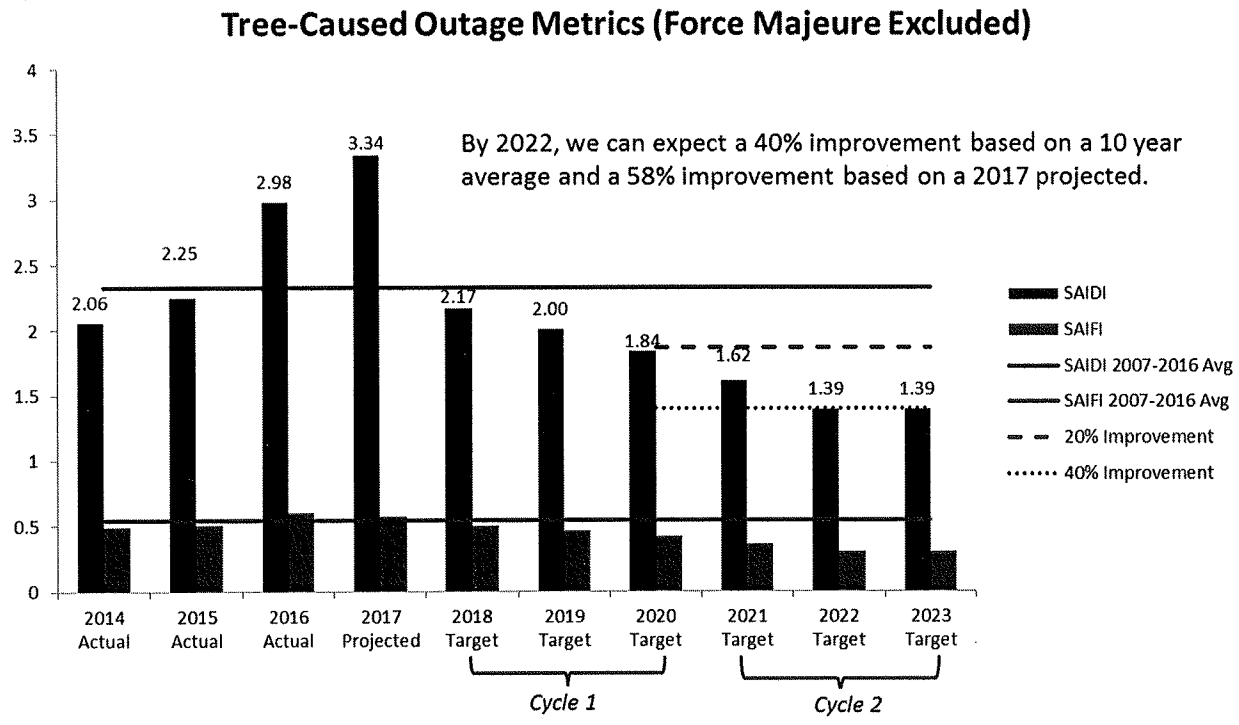
> ***'Plan B – Modified', was developed that would maintain overall forecasted system reliability at current levels, while continuing to offer discrete power quality and reliability improvements for certain segments of the network.***[102] **(emphasis added)**

98 EB-2017-0049, Exhibit A, Tab 3, Schedule 1, p. 14.
99 EB-2017-0049, Exhibit A, Tab 3, Schedule 1, p. 15.
100 EB-2017-0049, Exhibit A, Tab 3, Schedule 1, p. 15.
101 EB-2017-0049, Exhibit A, Tab 3, Schedule 1, p. 15.
102 EB-2017-0049, Exhibit A, Tab 3, Schedule 1, p. 16.

185. Plan B Modified was accepted by HONI's board of directors, and became the capital plan that underpinned HONI's application in this case. As part of HONI's evidence, they stated that Plan B Modified was an optimized investment portfolio in part due to the vegetation management plan that HONI had proposed as part of its originally filed application.[103]

186. Subsequent to their capital plan being filed, HONI undertook their second strategic shift regarding the vegetation management strategy. Working with Clear Path Utility Solutions LLC, HONI developed the "Optimal Cycle Protocol" ("**OCP**"), which focuses on defects on a three year cycle, foregoing the more comprehensive clearing that was the hallmark of HONI's earlier vegetation management.

187. In addition to OM&A cost savings associated with the shift in strategy that will be discussed further in section 6.4, HONI projects that the OCP will also produce significant reliability benefits. The impact of the benefit is outlined in the following table:[104]



103 EB-2017-0049, Exhibit A, Tab 3, Schedule 1, p. 18.
104 EB-2017-0049, Exhibit I, Tab 3, Schedule SEC-4, Attachment 4, p. 3.

188. The significant improvement on tree caused SAIDI and SAIFI would have a noticeable effect on HONI's reliability as a whole. As demonstrated during cross examination, a 40% improvement in tree-caused SAIFI would cause Plan B Modified to go from producing a 2% increase in SAIFI to producing a 7% increase in SAIFI.[105] Similarly, a 40% improvement in tree-caused SAIDI would mean that Plan B Modified would no longer improve SAIDI by 2% as originally envisioned, but rather 12%.[106]

189. Despite the projected improvements caused by the OCP vegetation management strategy, the strongly stated preferences of the part of customers to minimize rate increases,[107] and HONI's own board of directors challenging the company to produce a plan that minimized rate impacts while maintaining reliability, HONI has not reduced their capital spending proposal to reflect the new outcomes produced by the vegetation management strategy.

190. During cross examination,[108] and as part of their argument-in-chief,[109] HONI contended that capital spending could not be reduced, despite the improvement in reliability, because the level of capital spending was necessary to maintain the condition of the company's assets, such as poles and stations.

191. CME finds this argument unpersuasive, and states that HONI's spending does not address ratepayers' needs and preferences given the new vegetation management strategy.

192. CME agrees with Board Staff that HONI's capital investments should be lowered in order to exchange some of the reliability increases generated by the optimal cycle protocol for lower rates. The primary value of keeping assets in good condition is not intrinsic (keeping assets in good condition for their own sake) but rather the reliability level that assets in condition provide. As poor-condition assets are more likely to fail than assets in good

---

105 Transcript Vol. 7, p. 135.
106 Transcript Vol. 7, p. 135.
107 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, pp. 16, 121.
108 Transcript Vol. 7, p. 140.
109 AIC, pp. 123-126.

condition, keeping distribution assets in good condition help to maintain a stable level of reliability.

193. In this case however, reliability would be set to increase significantly. While lowering the capital investment might cause the degradation of some assets, the impact of this degradation would be felt in terms of reliability – exactly the sort of reliability vs. rates tension that customers were presented with in HONI's customer's engagement, where they unequivocally stated that keeping rates low was their top priority.[110]

194. Accordingly, while maintaining the condition of their assets is an important goal in general, CME submits that reducing the amount of capital spending to exchange the forecast improvements to reliability for a lower rate increase would not only be in keeping with the strongly held preference of ratepayers, but would rebalance and re-optimize the capital spending plan to accord with the updated vegetation management results forecast as the result of HONI's move to the OCP.

4.6 Pole Replacement Program

195. The Board directed that HONI "conduct an external benchmarking study on the unit cost of its pole replacement and station refurbishment programs against other utilities as well as carry out an internal trend analysis to show the variability of these unit costs over time (year over year)".[111]

196. The Navigant study places HONI in the bottom quartile when compared to its peers in terms of pole program costs. HONI ranks second to last in terms of pole program costs per pole touched and by annual spend,[112] and HONI's pole replacement cost is $8,266 or 16% higher than the mean of 11 comparators.[113]

---

110 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.3, Attachment 1, pp. 16, 121.
111 EB-2013-0416/EB-2014-0247.
112 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.6, Attachment 1, p. 8.
113 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.6, Attachment 1, p. 14.

197. Mr. Grunfeld of Navigant addressed concerns about the size of the peer group in the Navigant study as outlined in his opening statement and as quoted extensively by HONI in their submissions in chief. Mr. Grunfeld also cautioned against "pulling specific data out of our report, because of the limitations of the data that we had to work with." Mr. Grunfeld discussed the data with regard to pole replacement costs and indicated that comparator 39 had a three-year average pole replacement cost of $185 which he asserted "doesn't make a whole lot of sense" and that removing that comparator would result in an increase in the mean comparison group cost from $7,105 to $7,797.[114]

198. Mr. Grunfeld was questioned about these comments by CME on cross-examination. When asked whether Mr. Grunfeld followed up with comparator 39 with regards to their data it was their evidence that they did not have such a discussion:

> ***Ms. Durant:*** ***Did you follow up with utility number 39 in terms of why their cost was so low?***
>
> ***Mr. Grunfeld:*** ***We did not.***
>
> ***Ms. Durant:*** ***You just accepted their number and put it in your report?***
>
> ***Mr. Grunfeld:*** ***That's correct.***
>
> ***Ms. Durant:*** ***Okay, so to the extent that this number, you know, threw off the results, you never bothered to follow up to see what the actual number is?***
>
> ***Mr. Buckstaff:*** ***To be fair, we did actually contact them to ask. We didn't manage to connect with them and get an answer from them.[115]***

199. The Navigant witnesses selected data within the Navigant report in which HONI compared poorly to the comparator group when discussing the problems posed by small sample sizes.

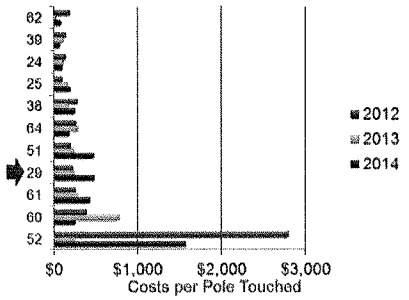
200. The Navigant witnesses ignored in their presentation the problems posed by small sample sizes when HONI performed well in comparison to the mean.

---

[114] AIC, pp. 77-78. Transcript Vol. 5, pp. 135-136.
[115] Transcript, Vol. 5, pp. 37-38.

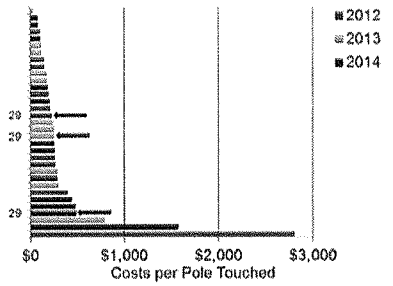
201. On cross-examination, CME drew Mr. Grunfeld's attention to the data collected regarding the costs of pole program costs per pole touched – an area in which HONI to was noted in the report to fall "very near the mean of the comparison group."[116] Mr. Grunfeld acknowledged that the outlier comparator in that sample would increase the average of the sample.[117] This data is excerpted below, with the red arrow indicating the location of HONI in relation to the comparators:

Figure 6. Pole Program Costs Per Pole Touched Grouped by Company



Note: In this comparison, pole touched means the total number of poles inspected, replaced, and refurbished.

Figure 8. Pole Program Costs Ranked by Annual Spend



202. HONI and Navigant submitted the Navigant report in response to the Board's directive to provide benchmarking. The data in the Navigant report should be utilized by the Board for that purpose.

203. CME submits that HONI's pole replacement costs are higher than the market average and that there should be a reduction in the revenue requirement for pole replacement of 16% – the amount above market average documented in the Navigant report.

---

116 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 1.6, Attachment 1, p. 8.
117 Transcript Vol. 5, pp. 39-40.

4.7 Distribution Station Refurbishments

204. CME has reviewed the submissions of Board Staff regarding distribution station refurbishments, and adopts their submissions. Specifically, CME agrees that HONI's cost estimates for refurbishments are problematic in the context of a Custom IR application, due to the fact that HONI has not provided a well-defined scope for their distribution station refurbishments.[118] According, CME agrees that the evidentiary gaps are sufficient to find that HONI has not justified the level of expenditure proposed for distribution station refurbishments.

4.8 Project Contingencies

205. According to HONI's evidence, capital spending is divided into two main categories: projects and programs. Projects are discrete investments that are usually not repeated, whereas programs are large scale, repeatable sets of investments, such as pole replacement.[119]

206. Programs and projects go through different budgeting processes. While program costs are derived based on unit-cost estimates,[120] projects are given a standard contingency amount except for projects over $5 million, which have their own contingency determined with specific reference to that individual project.[121] Currently, HONI's standard contingency for projects under $5 million is 10% of the total value of the project.[122]

207. In OEB Staff Interrogatory #121, HONI was asked to provide the 5 year historical percentage used as project contingency and to compare it to the present. HONI provided the following table in response:[123]

---

118 HONI's evidence is that distribution station refurbishments beyond the 12-18 month period are based on planner's estimates, which have an accuracy of +/- 50%, and are not always like-for-like replacements. See Transcript Vol. 9, p. 94.
119 Transcript Vol. 7, pp. 17-18.
120 Transcript Vol. 7, p. 97.
121 Transcript Vol. 7, p. 95.
122 Transcript Vol. 7, p. 95.
123 EB-2017-0049, Exhibit I, Tab 24, Schedule Staff-121, p. 2.

Year	Percentage of Contingency Used
2012	68%
2013	76%
2014	74%
2015	55%
2016	44%
2017	19%

208. As demonstrated by the table, HONI has been successful in refining its estimating and field execution, and now utilizes a much smaller percentage of their allotted contingency.

209. During cross-examination, HONI's witness responded that while the company had been successful at reducing contingency use to 19% in 2017 that the average use for the last three years would be around 40%.[124]

210. If HONI's contingencies are, on average, 60% higher than they need to be, and contingencies represent 10% of the total project cost, then it stands to reason that total project costs are overstated by HONI, on average, by 6%. When confronted with this on cross-examination, HONI's witness stated, *inter alia*, that the money not utilized as contingency for that project will then be "made available for other investments within the capital envelope."[125]

211. While CME has no doubt that redirecting contingency funds into other projects within the capital envelope is a helpful business management tool, it submits that the Board should approve capital spending amounts based on the best available information for the cost of the projects. To the degree that HONI is now over-estimating the costs of their projects due to their success at refining their forecasting, the Board should only approve the contingency amount that HONI actually needs to complete the project.

[124] Transcript Vol. 7, p. 96.
[125] Transcript Vol. 7, p. 96.

212. Accordingly, CME submits that reducing HONI's proposed capital spending on projects by 6% would align the proposed capital spending amounts with what HONI will likely require in order to complete the project work outlined in their application.

4.9 Smart Meter Replacements

213. As part of their system renewal spending, the Applicants propose to begin replacing smart meters that have reached the end of the manufacturer stated expected services lives. The Applicants propose to spend nearly $80 million dollars over the plan term, with $1.4 million being requested for 2021 and $78.7 million being requested for 2022.[126]

214. According to HONI's evidence, the replacements for 2021 and 2022 represent 16.5% of the total smart meter population.[127] Accordingly, the cost to replace the full smart meter complement will eventually total approximately $485.45 million, and represents a significant investment, both during this plan, as well as in HONI's next rate application.[128]

215. The primary value of smart meters is that they are capable of measuring "the total amount of electricity used over a billing period, record how much and when electricity is used (typically hourly), and transmit this information automatically to HONI's CIS (Customer Information System)."[129]

216. This technology allows more granular information about electricity use to be collected, and in tandem with time of use pricing represents a tool that helps ratepayers manage their energy use, manage their bills, and help the environment.

217. However, not all of HONI's smart meters are currently capable of that functionality. Due to issues with the cellular network in certain parts of the province, coupled with the current limitations of the smart meters purchased by HONI, there are currently 123,000 smart meters which cannot reliably communicate with the network.[130] As a result of their inability

126 EB-2017-0049, ISD: SR-14, p. 1. See also EB-2017-0049 Exhibit I, Tab 28, Schedule BOMA-25, p. 1.
127 EB-2017-0049 Exhibit I, Tab 28, Schedule BOMA-25, p. 1.
128 Calculated by increasing the $80.1 million listed as 16.5% to an amount that represents 100% of the total smart meter population.
129 EB-2017-0049, Exhibit B1, Tab 1, Schedule 1, DSP Section 2.3, p. 85.
130 EB-2017-0049, ISD: SA-03, p. 1.

to communicate with the network, these meters require manual reading and estimated billing for customers.

218. CME does not oppose the bulk of HONI's plan to replace smart meters, as CME recognizes that having working smart meters is a regulatory requirement.[131] However, HONI has discretion as to how it manages its smart meter program. Accordingly, CME opposes two aspects of HONI's proposal as it is currently constituted:

(a) The lack of independent verification of the appropriate service life of smart meters; and

(b) Replacing smart meters with units that still will not be able to reliably communicate with the network.

219. As part of their application, HONI proposes to spend $80 million on smart meter replacements, and the full replacement of smart meters will cost approximately $485 million. HONI's primary justification for this major investment was described as being because smart meters have reached the end of the manufacturer's expected service life.[132]

220. As part of the interrogatory process, HONI was asked whether or not the expected service life could be exceeded. In their response, HONI stated:

> ***Smart meters are a new technology and there is insufficient data to determine if the expected service life can be exceeded ...*** [133]

221. On cross-examination, CME attempted to discern what, if anything, HONI was doing to develop sufficient data to determine if the expected service life could be exceeded. HONI's witnesses stated that they weren't aware of any investigations into whether their manufacturer stated expected service life could be exceeded.[134] Additionally, at no point in HONI's application do they indicate that they propose to study this issue.

---

131 Transcript Vol. 8, p. 13.
132 EB-2017-0049, ISD: SR-14.
133 EB-2017-0049 Exhibit I, Tab 28, Schedule BOMA-25, p. 1.
134 Transcript, Volume 8, p. 15.

222. CME submits that given the magnitude of the investment required, the recurring nature of the investment (cyclically every 15 years according to HONI), and HONI's role as responsible stewards of ratepayer funds, the Board should refuse to allow HONI to uncritically accept the manufacturer's stated expected service life, and should instead direct HONI to study the issue of whether or not the expected service lives can be exceeded.

223. Even if HONI's investigation only determined that service lives could be exceeded by two or three years, that could likely save ratepayers tens if not hundreds of millions of dollars by delaying subsequent replacements. Furthermore, CME submits that the cost of such an investigation likely would be low, as HONI has a sizeable population of smart meters to work with, and a workforce with technical expertise in the area of smart metering.

224. With regard to the replacement of smart meters that cannot reliably communicate with the network with similarly deficient replacements, CME submits that the Board should disallow costs incurred for such replacements.

225. According to the Auditor General's 2014 report, HONI spent $660 million to install 1.2 million smart meters beginning in 2006.[135] The value or *quid pro quo* that ratepayers were supposed to receive from that sizable investment included the elimination of estimated billing, and manual meter reading.

226. According to HONI's evidence, 10 years later, 123,000 of those meters still are not able to reliably communicate with the network.[136] As a result of not being able to communicate with the network, these meters still require manual meter reading and the use of estimate billing. Accordingly, the 123,000 meters represent a ratepayer investment of

[135] Office of the Auditor General of Ontario, Annual Report 2014, s. 3.11, p. 367.
[136] EB-2017-0049, ISD: SA-03, p. 1.

approximately $67,650,000 for which ratepayers are not getting much, if any, of the promised value.[137]

227. In their current application, HONI proposes to replace all smart meters as they reach their manufacturer stated expected service lives. HONI confirmed, as part of the interrogatory process, that it planned to replace all meters that reached their expected service lives, including those that could not reliably communicate with the network.[138]

228. HONI was also asked whether the new replacement meters would be able to communicate with the network. In their response, HONI stated that while the advanced meter infrastructure would have greater reach now than it did 12 years ago:

> ***[R]eliability of communication will still be largely dependent on location of the meter and availability of cellular coverage.***[139]

229. During cross examination, HONI's witnesses confirmed that some of the replaced smart meters will still not be able to communicate with the network.[140]

230. CME submits that it is inappropriate and unreasonable for HONI to charge ratepayers for the installation of smart meters that don't work, and then to charge them again for replacements that also won't provide the services that they are intended to provide. This would essentially be asking ratepayers to pay twice for a benefit they are not receiving.

231. Furthermore, it entails a third charge. Consider the following two examples:

(a) If, after having replaced the deficient smart meter a second time, a new technology or design arrives that will allow a meter in that location to reliably communicate with the network, ratepayers will be required to replace the meter that was installed as the result of HONI's proposal in EB-2017-0049, thus requiring a third charge; or

---

137 Calculated by determining the average cost of a meter installation ($550) given the number of meters and total cost outlined by the Auditor General in their 2014 report, and multiplying it by the number of meters that currently cannot reliably connect to the network. CME notes that this simple calculation does not account for the fact that meters that cannot reliably connect with the network are in areas with less robust cellular coverage, so they would likely be more remote and thus more expensive to install.

138 EB-2017-0049, Exhibit I, Tab 29, Schedule CME-22.

139 EB-2017-0049, Exhibit I, Tab 29, Schedule CME-22, p. 2.

140 Transcript Volume 8, pp. 17-18.

(b) If, at the end of 15 years from their replacement, they still aren't able to communicate reliably with the network, HONI will demand ratepayers fund a third deficient meter.

232. In their argument-in-chief, HONI outlines the impacts of not replacing smart meters, and state that not replacing them would impose unacceptable risks because smart meters provide the information for accurate billing, and they create a 'mesh' that other meters rely on.[141] Neither of these concerns are engaged by smart meters that can't reliably communicate with the network, as they already rely on manual reading and estimate use, and necessarily aren't part of the 'mesh' network, since if they were, their signals would be picked up and communicated.[142]

233. Accordingly, CME submits that HONI's proposal to replace deficient meters with similarly deficient meters is inconsistent with the value for money that ratepayers depend on and the Board demands from distributors, and the Board should disallow all costs associated with the replacement of meters with similarly deficient ones that cannot reliably communicate with the network.

4.10 Integrated System Operating Center

234. As part of its overall general plant spending, HONI is proposing to spend $138.4 million to construct a new Integrated System Operating Center ("**ISOC**") to replace their current Backup Control Centre, and house other assets, including security operations and the Integrated Telecommunications Management Centre.[143] The cost of the project allocated to HONI's distribution business is $61.3 million.[144]

---

141 AIC, p. 105.
142 HONI's witness described the mesh network as being a series of smart meters, repeaters and collectors where meters communicate with one another until the information reaches a repeater that aggregates the information, and the aggregated information is sent through the cellular network back to HONI's system [Transcript Vol. 9, p. 190.]. The mesh therefore is only created when meters can speak to one another and eventually relay their information back to HONI's system. To the extent that smart meters are unable to provide their data, or the infrastructure isn't there for that information to be repeated or collected, the smart meters do not contribute to the 'mesh' network described.
143 AIC, pp. 113-114.
144 AIC, p. 114.

235. HONI has not provided in evidence all of the details necessary for the Board to make an informed decision on whether or not this project should be approved.

236. HONI has instead provided an investment summary document or "ISD" for the project. HONI contends that ISD GP-18, the ISD for the ISOC project, has all of the information that would be contained in the business case.[145]

237. However, on cross-examination, HONI's witness stated the RFP process would not automatically award the contract to the successful bidder. Instead, the successful proponent would enter into commercial negotiations with HONI.[146] HONI's witness also stated that as part of that negotiation, risks inherent in the project would be allocated between HONI and the counterparty contractor. [147]

238. Despite not knowing the full extent of the risks that HONI will have to bear, the company is still asking the Board to approve a $138.1 million expenditure. CME submits that this is an inappropriate way to approach a rates application.

239. The Board's role is to determine whether or not to approve capital spending in light of the Board's statutory objectives as set out in section 1 of the *OEB Act*.[148] The first listed objective in that section is:

> ***To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.***[149]

240. CME submits that the Board should be provided with the complete picture of the proposed project before being asked to approve it. That is the only way to ensure that the Board can successfully protect the interests of consumer, and uphold its other statutory objectives.

241. Prematurely asking for the Board's approval risks running into situations where details that are possibly material to the outcome of the project, including the allocation of risk between

---

145 Transcript Vol. 10, p. 26; AIC p. 115.
146 Transcript Vol. 10, p. 32.
147 Transcript Vol. 10, p. 32.
148 S.O. 1998, c. 15, Sched. B (*"**OEB Act**"*).
149 *OEB Act*, s. 1(1)1.

the utility and the contractor are not available to the Board. This would lead to worse outcomes for the ratepayers of Ontario, as well as the distribution network.

242. Accordingly, CME submits the Board should withhold any approval for spending on the ISOC project until HONI is able to provide all of the details necessary for the Board to make an informed decision on whether or not the Applicant should go ahead with the ISOC project as proposed, especially in light of the fact that HONI proposes to spend over $100 million of ratepayer's money on the ISOC project.

5.0 RATE BASE AND COST OF CAPITAL

5.1 Working Capital

243. To support its proposal regarding working capital requirement, HONI provided a detailed lead-lag study that was completed by Navigant Consulting Inc.[150] CME submits that the OEB should accept the results of the Navigant study which resulted in working capital requirements in the 7.7% range.

244. CME also supports the additional change made to the working capital component of rate base that was made to reflect the impact of the Fair Hydro Plan on cash working capital as set out in HONI's responses to interrogatories I-33-Staff 179 and I-34-Staff 181. Both of these interrogatory responses were filed on February 12, 2018 and HONI indicated that they reflect both the changes due to the Fair Hydro Plan and the changes described in Exhibit Q, Tab 1, Schedule 1 that was filed on December 21, 2017. These changes result in a reduction in the working capital component of rate base of approximately $40 million in each of 2018 through 2022.

245. HONI also filed an updated load forecast on February 2, 2018.[151] This load forecast reflected a reduction in the GWh delivery forecast in each of 2018 through 2022 from what

[150] EB-2017-0049, Exhibit D, Tab 1, Schedule 1, Attachment 1.
[151] EB-2017-0049, Exhibit I, Tab 46, Schedule Staff-219.

was included in the updated evidence.[152] The reduction in the GWh delivery forecast ranges from about 2.7% to 3.2% over this period.

246. CME assumes that HONI has included this reduction in the load forecast as part of the update to the cash working capital component of rate base in I-33-Staff 179. However, the response to that interrogatory only notes that the update to the cash working capital reflects the impacts of the updates included in Exhibit Q, Tab 1, Schedule 1, which was completed prior to the interrogatory responses and which did not reflect a reduction in the load forecast that was filed as part of I-46-Staff 219 on February 2, 2018.

247. CME submits that the OEB should ensure that HONI updates the cash working capital component of rate base to reflect the lower load forecast if it has not already done so. Similarly, CME submits that the OEB should direct HONI to update the cash working capital component of rate base to reflect any further changes to the forecast approved by the OEB and any changes to OM&A approved by the OEB.

6.0 OPERATIONS MAINTENANCE & ADMINISTRATION COSTS

6.1 Executive Compensation

248. The issues list in this proceeding had narrowed the scope at which executive compensation was at issue in light of the Board's EB-2016-0160 transmission decision.

249. The *Urgent Priorities Act, 2018* received royal asset on July 25, 2018. Schedule 1 to the *Urgent Priorities Act, 2018* is the *HONI Accountability Act, 2018*, which amends section 78 of the *OEB Act* as it relates to executive compensation. The Board is precluded from including "any amount in respect of compensation paid to the Chief Executive Officer and executives, within the meaning of the HONI Accountability Act, 2018 of Hydro One Limited." The term "executive" is defined as "any person who holds the office of executive vice-president, vice-president, chief administrative officer, chief operating officer, chief

[152] EB-2017-0049, Exhibit E1, Tab 2, Schedule 1.

financial officer, chief information officer, chief legal officer, chief human resources officer or chief corporate development officer, or holds any other executive position or office, regardless of the title of the position or office."

250. In accordance with the OEB's letter of August 3, 2018, CME is making no submissions on the issue of executive compensation at this time.

6.2 Employee Compensation (other than Pension)

251. HONI asserts that it continues to take steps to ensure that its human resources related costs are appropriate and reasonable. It purports to have taken into account Board and stakeholder concerns regarding human resources related costs and has made "important progress" in the area. HONI continues to assert that HONI's "compensation strategy is essential to the company in order to attract, retain and engage the caliber of talent required to deliver on its commitments to ratepayers and corporate strategy."[153]

252. Notwithstanding these assertions, employee compensation remains above market median. Recent changes to HONI's employee compensation program highlighted in the Application are not required to drive productivity and, instead, add increased costs to the ratepayers.

6.2.1 HONI Compensation Remains Above Market Median and No Evidence that Compensation Levels are Required to Attract and Retain Necessary Employees

6.2.1.1 Reductions for Compensation in Past OEB Decisions

253. In the last HONI Distribution Rate application, HONI produced a compensation benchmarking report by Mercer which demonstrated that compensation was 10% higher than the median of its comparator group. The Board commented that:

> ***HONI did not provide sufficient evidence in support of its proposed compensation spending. The company did not demonstrate that the market 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***

[153] AIC, p. 135.

> ***the percentage of compensation costs that will be included in the rates paid by HONI's Customers.***[154]

254. The Board disallowed half of the 10% premium over market median. In doing so, the Board recognized HONI's progress in "getting closer to market median" and directed that HONI file "a compensation study similar to the one filed in this proceeding so that the OEB can continue to benchmark HONI's compensation against that paid by comparable companies."[155]

255. In EB-2016-0160, HONI's last Transmission Rate Application, the Board was concerned about HONI's lack of progress towards market median and reduced HONI's compensation by $15 million per year:

> ***The OEB is also concerned that HONI's progress towards bringing its total compensation levels down to the market median has now reversed. The Mercer Report indicates that a reduction in compensation amounts of about $12.5 million is required to bring compensation levels to that median. Moreover the OEB agrees that HONI's total compensation amounts are likely understated because not all items of HONI compensation were included therein.***
>
> ***After considering all of the evidence related to the amounts for compensation that HONI seeks to recover from transmission services ratepayers, the OEB finds that compensation amounts in the total OM&A envelopes for 2017 and 2018 of $412.7 million and $409.3 million are unreasonably high by an amount of approximately $15.0 million in each year. These compensation envelope reduction amounts reflect the OEB's finding that HONI has failed to establish that the significantly increased levels of compensation for executives, directors and other managerial personnel should be recoverable from ratepayers.***[156]

256. The Board also considered incentive payments to employees in its reasons in EB-2016-0160. As in this case, the incentive payments, particularly the short-term incentive program, was available to management level employees and not just executives. Submissions were made by OEB staff and several intervenors regarding the significant magnitude of incentive payment amounts and their terms which were heavily weighted to

---

154 EB-2013-0416 at p. 24.
155 EB-2013-0416 at p. 25.
156 EB-2016-0160 at p. 59.

prompt the delivery of value to shareholders.[157] The Board stated that it "shares the concerns of those parties who expressed the view that costs of incentive plans that are primarily designed to deliver value to the shareholder should not be recoverable from utility ratepayers."[158]

257. The Board found that 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.[159]

7.0 Current Compensation Evidence

258. HONI produced two Mercer reports in this application.

259. The first is dated December 12, 2016 and considers 2016 compensation levels ("**2016 Mercer Report**").[160] HONI had also filed the 2016 Mercer Report in the transmission proceeding.

260. The second Mercer report is dated April 4, 2018 and considers 2017 compensation levels ("**2017 Mercer Report**").

261. The 2016 Mercer Report found that HONI was 14% above market median. The 2017 Mercer Report recalculated HONI's compensation at 12% above market median.[161]

262. The 2017 Mercer Report, however, contains important limiting language as a result of altered comparator companies and benchmark jobs. The 2016 Mercer Report included as comparator employers utilities, local distribution companies and other regulated businesses. The 2017 Mercer Report expanded the comparator employers to include organizations from which HONI contract employees (i.e. private companies).[162] As a result

157 EB-2016-0160 at p. 59.
158 EB-2016-0160, p. 57.
159 EB-2016-0160, pp. 59-60.
160 EB-2017-0049, Exhibit C1, Tab 2, Schedule 1, Attachment 5.
161 Mercer "Compensation Cost Benchmarking Study Hydro One Networks Inc.," 04 April 2018.
162 CME Compendium Panel 2, Exhibit K3.3, pp. 61-62.

of the altered comparator groups, the 2017 Mercer Report states that "While these changes may have an impact on the study-over-study comparison, Mercer believes they better reflect the current workforce and balance of jobs at HONI."[163]

263. Mercer was cross-examined on the significance of the altered comparator group in the 2017 Mercer Report and, in particular, was asked to explain why one-third of the cohort of organizations that HONI was benchmarked against had changed since the 2016 Mercer Report. Mercer acknowledged that these changes would have an impact on the findings of the study:

> ***Ms. Durant:*** ***So in 2017, there is a roughly one-third turnover in terms of comparable organizations. What is the significance of that?***
>
> ***Mr. Morris:*** ***It does have an effect on the findings of the study. Different organizations have different pay regimes. It would be reflected in the outcome of the study.***[164]

264. CME submits that movement towards market median from the 2016 Mercer Report and 2017 Mercer Report is marginal and that the changes may have resulted entirely as a result of the altered comparator groups and jobs benchmarked. In any event, HONI's positioning when compared to market median continues to trend away from market median.

265. CME has two specific concerns regarding HONI's compensation. First, HONI's evidence demonstrates a significant increase in non-represented compensation, particularly as it relates to short-term incentive payments.[165] Changes in compensation for the non-representative group are within HONI's control (rather than being limited by collective bargaining agreements) and spending on this employee group has not been curtailed or adjusted downwards. Instead, new programs such as the new Short-Term Incentive Program (the "**STIP**") have been introduced.

---

163 Mercer "Compensation Cost Benchmarking Study Hydro One Networks Inc.," 04 April 2018 at p. 4.
164 Transcript Vol. 3, p. 93.
165 EB-2017-0049, Exhibit C1, Tab 2, Schedule 1, Attachment 6, p. 3.

266. The STIP is directly contributing to HONI's above-market positioning.[166] It was confirmed by the Mercer representative that the phrase "higher short-term incentive payouts" referred to in the 2017 Mercer Report, is a reference to HONI paying its employees more in short-term incentive payouts than it had historically.[167]

267. Throughout HONI's application the company focuses on the STIP as "at risk" pay which is required to: acquire talent, [168] retain a high-performing workforce;[169] and to put a much greater emphasis on senior management that is tied to achieving specific outcome measures.[170]

268. HONI was asked to provide copies of any studies conducted by HONI prior to implementing the STI which indicated that management-level turnover was a concern. HONI responded that it did not conduct the requested studies. HONI explained that the reference that "Incentive-based compensation awards performance and allows the Company to attract, motivate and retain qualified employees in a competitive labour market" was "a general statement intended to explain the rational and benefits of incentive based compensation."[171] It is noteworthy that despite spending more on variable pay, there has been no improvement in management attrition levels. In fact, management attrition has increased from 2015 to 2018 from 7.35% to 13.6%.[172]

269. CME submits that there is no evidence that the STIP is actually "at risk" pay. A copy of the STIP Employee Guide is in the record and was reviewed with Panel 2.[173] The STIP Employee Guide states that "No STIP payout (team or individual components) will be made if the Individual Performance Rating is Did Not Meet Expectations."[174] Despite this language, for the performance year 2016 (paid in 2017), HONI has advised that "all eligible

166 Mercer "Compensation Cost Benchmarking Study Hydro One Networks Inc.," 04 April 2018, p. 2.
167 Transcript Vol. 3, pp. 91-92.
168 EB-2017, 0049, Exhibit C1, Tab 2, Schedule 1, p. 19.
169 EB-2017, 0049, Exhibit C1, Tab 2, Schedule 1, p. 19.
170 EB-2017, 0049, Exhibit C1, Tab 2, Schedule 1, p. 19.
171 EB-2017-0049, Exhibit I, Tab 20, Schedule CME-31.
172 EB-2017-0049, Exhibit I, Tab 40, Schedule SEP-15, pp. 1-2.
173 EB-2017-0049, Exhibit I, Tab 40, Schedule CME-34. CME Compendium Panel 2, Exhibit K3.3, p. 38.
174 CME Compendium Panel 2, Exhibit K3.3, p. 39.

MCP employees received an (sic) STIP payment. The average STIP payment was $28,346. The average STIP amount for employees below the Executive Vice President level was $24,896."[175] This included payments being made to employees who did not meet expectations.[176]

270. Mr. McDonell was asked about the requirement that an employee must meet expectations in order to obtain a STIP. It was his belief that the requirement did not exist in past years and that HONI was looking at implementing it going forward. Mr. McDonell was not able to explain whether another version of the STIP guide was available in 2016 which would have expressly permitted employees who did not meet expectations to receive a STIP. [177]

271. Further, CME has the same concerns expressed by the OEB, several interveners and the Board that were raised in EB-2016-0160 regarding the value obtained from ratepayers as a result of the incentive payments. Both the 2017 and 2018 Team Scorecards, which are utilized in calculating the amount of STIP payments have identified "Net Income to Common Shareholders" as being worth 30% of the overall team score. This is the largest component of the Team Scorecard.[178]

272. Accordingly, it is CME's position that the STIP is an expensive program that was implemented without study as to how it would provide improvements to HONI's staffing situation, it is contributing to HONI's above-market positioning and that it has limited benefit to ratepayers.

273. Second, HONI is now offering share grants to both its PWU represented employees (commencing in 2017) and with its Society represented employees (commencing in 2018). The cost of these programs allocated to distribution is just under $4 million for the PWU in

175 EB-2017-0049, Exhibit I, Tab 40, Schedule CME-34.
176 EB-2017-0049, Exhibit JT 2.8.
177 Transcript Vol. 3, pp. 104, 105, 109, 110.
178 CME Compendium Panel 2, Exhibit K3.3, pp. 45 and 46.

2017 and just under $1.5 million for the Society in 2018.[179] These share grants are not tied to any performance-based incentives.[180]

274. HONI was asked on cross-examination where these shares are coming from and whether HONI is purchasing the shares from the market for distribution to the employees. HONI's evidence was that there was that HONI incurred no direct cost as a result of issuing the shares to employees and that the only loss was the lost opportunity cost of issues the shares to other shareholders.[181]

275. It is CME's position that the costs associated with the PWU and Society Share Grant programs are not real costs incurred by HONI and, as a result, these are not appropriate costs to be recover from ratepayers.

8.0 Reduction in Compensation Request Using Past Methodology

276. HONI asked Mercer to calculate the dollar amount above market Median based on the 2016 Mercer Report. Mercer's estimate was that the dollar amount was $71 million as detailed in SEC-83. The updated calculation based on the 2017 Mercer Report was $70.2 million.[182]

277. HONI was asked to calculate the dollar difference between the weighted average total compensation for HONI's employees allocated to its distribution business and the P50 median used in the 2017 Mercer Study. This information was provided for 2017 and for the 2018 test year.[183] The calculations were provided in the below chart:

[179] EB-2017-0049, Exhibit C1, Tab 2, Schedule 1, Attachment 6, pp. 5-6.
[180] Transcript Vol. 3, p. 114.
[181] Transcript Vol. 3, pp. 187-188.
[182] EB-2017-0049, Exhibit I, Tab 40, Schedule SEC-83 updated. SEC Cross-Examination Compendium Panel 2, Exhibit. K3.6 p. 59.
[183] EB-2017-0049, Exhibit I, Tab 40, Schedule SEC-84.

The calculation is provided below in Table 1. As shown in Table 1, the amounts for 2017 and 2018 for the difference between the weighted average total compensation for employees allocated to the distribution business are $18.46 million and $17.48 million, respectively.

Table 1

	2017	2018
	Bridge	**Test**
$ Over Median	$70.92	$70.92
TDOC Splits*		
*Consistent with Labour Content Method in Exhibit D1, Tab 3, Schedule 1, Attachment 1		
Tx OMA (%)	17.6%	16.4%
Dx OMA (%)	26.0%	24.7%
Tx Cap (%)	31.0%	30.3%
Dx Cap (%)	25.3%	28.6%
Allocation of $		
Tx OMA ($)	$12.49	$11.64
Dx OMA ($)	$18.46	$17.48
Tx Cap ($)	$22.00	$21.52
Dx Cap ($)	$17.96	$20.27
Total	**$70.92**	**$70.92**

278. CME submits that the Board should reduce the annual compensation costs to the extent that they are above market median as outlined in the above chart.

8.1 Pension

279. CME has had an opportunity to review Board Staff submissions regarding HONI pension contributions, and adopts their submissions.

280. In particular, since the actuarial valuation provided by HONI indicates that no employer contributions are presently requires as the fund is in a significant surplus position of $434 million, CME agrees that there should be an additional $17 million reduction from OM&A and $20 million in capital as described in Board Staff's submissions.

8.2 Vegetation Management

281. As discussed in section 4.5, HONI's vegetation management strategy has undergone two major shifts during the course of this application. The most recent shift saw HONI work with Clear Path Utility Solutions LLC to develop the OCP vegetation management

strategy, which focuses on clearing defects on a three year cycle and foregoing the eight year, more comprehensive clearing strategy HONI had been employing.

282. Steven Tankersley of Clear Path Utility Solutions LLC provided HONI with the report on which the OCP is based. Mr. Tankersley was produced for cross-examination in this proceeding.

283. HONI stated in its updated evidence that "HONI views the 2018-2012 period as transitional, and HONI anticipates incurring transition costs with this new approach."[184] When asked for details about these transition costs, HONI responded that they were made up of two components. The first was "the elimination of 798,000 backlogged defects. Eliminating this backlog is estimated to cost $127.7 million between 2018 and 2022." The second was an estimated $2 million for change management.[185]

284. Elsewhere in HONI's submissions and evidence the Company submits that it will begin seeing the reliability benefits of the OCP immediately. For instance, HONI is targeting an improvement in SAIDI in 2018 from their ten year average, and a 35% reduction in SAIDI from 2017 to 2018.[186] Similarly, HONI is also targeting a reduction in SAIFI in 2018 compared to the 10 year average.[187]

285. In this application HONI seeks to rely on the immediate reliability improvements set out in the Clear Path report, but provide the ratepayers with none of the cost savings. It is CME's position that ratepayers should benefit from the immediate decrease in costs for vegetation management which are stated to decrease from $11,000 per kilometer to $3,000 per kilometer after the first year of the program (2018).

286. Steven Tankersley of Clear Path provided HONI with the report on which the OCP is based. Mr. Tankersley also testified in this proceeding. Mr. Tankersley described that as

184 EB-2017-0049, Exhibit Q, Tab 1, Schedule 1, p. 14.
185 EB-2017-0049, Exhibit I, Tab 29, Schedule CME-27, p 1.
186 SEC Compendium Panel 5, Exhibit K6.2, p. 137.
187 SEC Compendium Panel 5, Exhibit K6.2, p. 137.

part of his mandate he worked with ArborMetrics to inspect the current state of HONI right of ways in order to have a clear picture of their current state.[188]

287. Mr. Tankersley explained in his evidence that historically HONI was operating on a stated eight-year cycle which they were not achieving.[189] He also agreed that "as you wait longer to clear the right of way, there is going to be more defect(s)."[190] This fact was documented in his report in Figures 2 and 3 (excerpted below):

> Figures 2 and 3 (below) illustrates that current defects and projected defects follow the same pattern of increase over time. This outcome is not surprising as individual tree species have a typical genetic growth pattern and response to environmental conditions, which would naturally produce a similar increase over time.

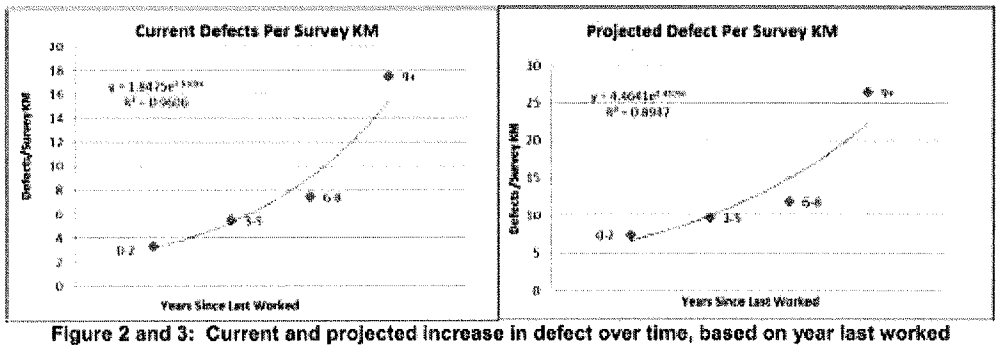


Figure 2 and 3: Current and projected increase in defect over time, based on year last worked

288. Mr. Tankersley wrote in his report that:

> ***It is estimated that 2.1 million trees will need work over the first 3-year cycle to achieve base level defect control, 700,000 trees per year as compared to 800,000 under the current work scope. The major difference in approach is an optimized defect-based work scope combined with a strategic brush control regimen that significantly reduces cost per km from the current $11,000 per km to an estimated $3,000 per kilometre for the first full cycle.***

289. Mr. Tankersley gave oral evidence about the work involved in addressing the backlog in cross-examination and its impact on costs. Ultimately, it is Mr. Tankersley's evidence that backlog costs are budgeted within his report:

> ***Ms. Durant:*** ***... And just one last question for you, sir, before we move on. If we go to page 4 of the PDF, which is***

[188] Transcript Vol. 6, p. 29.
[189] Transcript Vol. 6, p. 30.
[190] Transcript Vol. 6, p. 31.

page 3 of the report. And I'm looking at the heading "forecast workload and cost". I'll just read from the report. It says:

"It is estimated that 2.1 million trees will need work over the first three-year cycle to achieve base level defect control..."

Let me stop there. When you say "base level defect control", you need to clear that many trees in three years to basically get the system caught up, right? Is that what you mean by "base level"?

Mr. Tankersley: *You are doing two things with that. So you have an existing defect load over the system which is roughly 800,000 trees that are existing. Then there are the remaining portion of that would be to avoid having defects on that same feeder for the duration of that cycle.*

Ms. Durant: *Um-Hmm.*

Mr. Tankersley: *Presumably after you get through the first cycle, the second cycle, you are not dealing with existing defects, you are dealing with preventing – prevention of future defects.*

Ms. Durant: *That's all included in your scope of work and your costing, right, that model?*

Mr. Tankersley: *Correct.*

Ms. Durant: *Okay. And ultimately at the end of that paragraph, in terms of costing:*

"This regimen will significantly reduce cost per kilometres from 11,000 per kilometre to an estimated 3,000 per kilometre after the first cycle."

Is that right?

Mr. Tankersley: *We're suggesting that will occur throughout the first cycle.*

Ms. Durant: *Okay, so it's not like you have to wait 'til the third year to get the $3,000 – get down to $3,000 per kilometre. Gradually throughout the first three-year cycle the costs are going to go down?*

Mr. Tankersley: *That is the intent, yes.*

...

Ms. Durant: *So you don't have to wait for after three years to start saving costs?*

Mr. Tankersley: Correct.

290. Mr. Tankersley also believed that HONI would achieve the costing amounts as outlined in his report based on the projections which he had seen.[191]

291. HONI has taken the position that there will be no costs savings for the duration of the rate application period as a result of the implementation of the OCP. This is contrary to the evidence of Mr. Tankersley with regards to cost savings. Mr. Tankersley has estimated the annual cost of the OCP as being $108,400.451 or a 3-year cost of $325,201,352, as outlined in the chart below.

Forestry Survey Assessment

hydro one

Estimated Cost of Unit Type				
Unit Type	Zone A	Zone B	Zone C	Zone D
R1 (10-30 cm)	$125	$98	$102	$73
R2 (30-60 cm)	$313	$245	$255	$183
R3 (60-90 cm)	$500	$392	$408	$292
R4 (>90 cm)	$1,000	$784	$816	$584
Prune	$125	$98	$102	$73
Unit Price*	$162.80	$124.75	$138.75	$143.15

Unit Type Percent from Survey			
Unit Type	Diam On-ROW	Diam Off-ROW	Hazard
R1 (10-30 cm)	70.1%	69.3%	69.3%
R2 (30-60 cm)	27.2%	26.4%	26.4%
R3 (60-90 cm)	2.7%	4.4%	3.4%
R4 (>90 cm)	NA	NA	1.0%
Inspect & Notify - calculated at annual $2.5M per zone			

*Weighted unit price based on 50/50 split of prune and removals and percent of removal class.

Table 7: Unit Cost Projections

Annual	Zone A	Zone B	Zone C	Zone D	Annual	3-Year Totals
KM	10,383	8,060	10,070	5,770	34,282	102,847
Defects	139,621	223,824	238,935	101,955	704,336	2,113,007
Cost (incl. insp./notify)	$25,230,852	$30,422,190	$35,652,051	$17,095,357	$108,400,451	$325,201,352

Table 8: Workload and Cost Projections by Zone for a Three Year Cycle

292. HONI's annual cost for vegetation management spending is $150 million in 2018.[192]

---

191 Transcript Vol. 6, p. 25.
192 EB-2017-0049, Exhibit C1, Tab 1, Schedule 2, p. 3.

293. CME submits that the vegetation management related revenue requirement should be reduced to $120 million in the test year such that ratepayers can benefit from the cost savings from the OCP during the current rate period.

9.0 DEFERRAL AND VARIANCE ACCOUNTS

9.1 Existing Deferral and Variance Accounts

294. As part of its updated evidence, HONI proposed to recover a debit balance from ratepayers of $30.9 million.[193] This was the forecasted balance at the end of December 31, 2016 for the regulatory accounts plus interest through to the end of 2017. HONI further proposed to recover this amount from ratepayers in equal annual amounts of $6.2 million over the 5-year IRM term.[194] This 5-year recovery period, according to HONI, was chosen to align customer needs for lower bills, the financial needs of HONI and the rate impact.

295. As noted during the hearing,[195] the OEB issued a letter to HONI indicating that it would be undertaking an audit of HONI's Regulated Price Plan settlement process and to assess the allocation methodology HONI uses to assign balances for Group 1 deferral and variance accounts for all acquired utilities from 2015 onwards.

296. As a result, HONI has proposed to recover the balances of Group 1 accounts as of December 31, 2017 and Group 2 balances as of December 31, 2016. Interest would continue to be calculated on these amounts through to the end of December 31, 2017. The resulting amount to be recovered from ratepayers as part of this proceeding is $8.3 million, as shown in the table on page 153 of HONI's Argument-in-Chief. HONI has also proposed to recover this amount over 1 year.

297. CME is concerned with the delay in the recovery of the $22.6 million different between the original proposal ($30.9 million) and the updated proposal based on the OEB audit ($8.3

193 EB-2017-0049, Exhibit F1, Tab 2, Schedule 1, Table 1.
194 EB-2017-0049, Exhibit F1, Tab 2, Schedule 1, Attachment 1.
195 Transcript Vol. 10, pp. 86-87.

million). It is not clear to CME how long the OEB audit will take, but it has the potential to be a lengthy process.

298. As the OEB is aware, short-term interest rates have risen significantly. The OEB's prescribed interest rate for deferral and variance account balances has risen from 1.1% in the third quarter of 2017 to 1.50% in the fourth quarter of 2017, to the current level of 1.89% in the second and third quarters of 2018. This is an increase of more than 70% in the last year, and further increases are likely.

299. CME is concerned that any significant delay in the recovery of the $22.6 million will result in substantial increases in the amounts ultimately recovered from ratepayers due to the interest cost. At the current 1.89% rate, the incremental annual interest cost is more than $400,000 per year. A long delay in the recovery of the $22.6 million and/or further increases in interest rates will only make the increase larger.

300. CME submits that the OEB should consider requiring HONI to recover the $30.9 million over 5 years, as originally proposed, but to track any differences in the amount and/or allocation of the amount to ratepayers in a variance account, subject to the outcome of the OEB audit. This would reduce the cost to ratepayers in the long term through reduced interest costs and would still allow the results of the audit to be reflected when the audit has been completed. Some ratepayers may be allocated less of the amount to be recovered and others more than what was built into the riders. However, this amount is likely to be small compared to the overall amount and would attract significantly less interest costs.

301. If the OEB determines that the recovery of the $8.3 million amount is appropriate, CME submits that it should direct HONI to recover this amount over a 2-year period. The 1-year disposition period proposed by HONI may result in an increase in the first year, followed by a decrease in the second year if the results of the audit cannot be implemented by the second year of the IRM term. CME believes that the timing of the audit completion would

make it unlikely that the impacts could be implemented before the third year of the IRM term.

302. CME has reviewed the balances in the accounts and believe they are correct.

303. With respect to the continuance of the existing accounts requested by HONI, CME generally supports the continuance of the accounts as requested by HONI, with one exception: disposing of amounts below the materiality threshold.

304. As shown in Table 2 in the updated Exhibit F1, Tab 1, Schedule 1, several of the existing deferral and variance accounts have balances at the end of 2016 that are less than HONI's proposed materiality threshold of $1 million.

305. CME proposes that while the accounts should be continued, if the balances are less than the materiality threshold ($1 million as proposed by HONI, or some other level as approved by the OEB) when it is time to clear those accounts, the recovery/disposition of the amounts should be denied based on this lack of materiality. This would be consistent with the Board's requirements for new deferral and variance accounts set out in Section 2.9.6 of the *Filing Requirements for Electricity Distribution Rate Applications – 2017 Edition for 2018 Rate Applications* ("*Filing Requirements*").[196] Accordingly, CME submits that there should be no difference in the treatment of existing and proposed (or new) deferral and variance accounts.

306. A review of the table found at page 153 of the HONI Argument-in-Chief, in which HONI shows the composition of the $8.3 million claim to be recovered from customers, shows that 5 out of the 17 accounts have balances of less than $1.0 million (debit or credit). The sum of these 5 accounts is $1.0 million to be recovered from ratepayers. CME submits that each of the 5 accounts listed is immaterial and HONI should expense these amounts in the normal course.

[196] Chapter 2: Cost of Service, dated July 20, 2017.

307. If the OEB determines that HONI is allowed to recover these immaterial amounts from ratepayers because the balances are historical balances from the end of 2014 and 2016, CME submits that it should indicate that going forward accounts with balances that are not material may not be eligible for disposition to ratepayers.

9.2 New Deferral and Variance Accounts

308. CME supports the proposed new deferral and variance accounts as being appropriate, with two exceptions: the ESM deferral account and the CIS variance account.

309. As indicated in section 3.6, CME submits that the earnings sharing mechanism deferral account should record the ratepayer share of any over earnings in a given year during the IRM term. CME does not support the use of 100 basis point deadband before the earnings sharing in favour of ratepayers takes effect. CME does support the asymmetric nature of the account in that the account would record amounts in favour of ratepayers if HONI over earns, while no entries would be made to the account if HONI under earns from the allowed return on equity.

310. Additionally, as noted in section 3.6, CME does not support the clearance of this account at HONI Distribution's next rebasing. The account should be cleared annually to minimize any intergenerational inequity.

311. CME generally supports the CISVA as proposed, with the exception of the adjustment of 98% of the in-service additions proposed by HONI. As indicated under section 3.3.2, there is no justification for the OEB to approve a 2% buffer amount for HONI.

312. In addition to the above two noted exceptions, CME submits that the forecasted amounts to be included in new deferral or variance accounts must exceed the OEB-defined materiality threshold and have a significant influence on the operation of the distributor, as set out in Section 2.9.6 of the OEB's *Filing Requirements.* If the costs are not material, they must be expensed in the normal course and addressed through organizational productivity improvements.

9.3 Discontinuance of Variance Accounts

313. CME has reviewed the four accounts for which Hydro One is requesting discontinuance and supports the closure of those accounts.[197] In each case, there does not appear to be any future requirements associated with the purposes for which those accounts were originally proposed and established.

10.0 COSTS

314. CME requests that it be awarded 100% of its reasonably incurred costs in connection with this matter.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 10th day of August, 2018.

Emma Blanchard
Erin Durant
Scott Pollock
Randy Aiken

Counsel and Consultant for CME

OTT01: 9122103: v3

[197] EB-2017-0049, Exhibit F1, Tab 3, Schedule 1, p. 2.