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BY COURIER

March 28, 2019

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
Suite 2700, 2300 Yonge Street
P.O. Box 2319
Toronto, ON M4P 1E4

Dear Ms. Walli,

EB-2018-0130 - Hydro One Networks Inc.'s 2019 Transmission Revenue Requirement – Reply Submission

In accordance with Procedural Order No.1 in this proceeding, please find enclosed Hydro One Networks Inc.'s reply submission.

This filing has been submitted electronically using the Board's Regulatory Electronic Submission System and two (2) hard copies will be sent via courier.

Hydro One's points of contact for service of documents associated with the Application are listed in Exhibit A, Tab 2, Schedule 1.

Sincerely,

ORIGINAL SIGNED BY FRANK D'ANDREA

Frank D'Andrea

ONTARIO ENERGY BOARD

OEB PROCEEDING EB-2018-0130

APPLICATION FOR ELECTRICITY TRANSMISSION REVENUE REQUIREMENT EFFECTIVE JANUARY 1, 2019

REPLY SUBMISSION OF
HYDRO ONE NETWORKS INC.

March 28, 2019

INTRODUCTION

On October 26, 2018, Hydro One Networks Inc. ("Hydro One") filed an application with the Ontario Energy Board (the "OEB"), pursuant to section 78 of the *Ontario Energy Board Act, 1998* (the "Act"), seeking approval of its 2019 transmission revenue requirement (the "Application"). Hydro One requested this approval on the basis of a mechanistic adjustment to its 2018 approved revenue requirement using a Revenue Cap Index approach, which accounts for inflationary pressures and incents continuous improvement. Relative to 2018, the Application is estimated to result in an increase to Hydro One's transmission revenue requirement of 2.6% for 2019. This would result in a total bill impact of 0.2% for a typical Residential (R1) customer consuming 750 kW per month and 0.1% for a typical energy-billed General Service (GS <50 kW) customer consuming 2,000 kWh per month.[1]

This is Hydro One's reply submission in respect of the Application. It is Hydro One's submission that the proposed 2019 transmission revenue requirement is reasonable and that the Application should be approved as filed, and as further proposed by the applicant during the proceeding. Similar to OEB staff's submission, this reply submission is organized so as to address the following five aspects:

1. Proposed Revenue Cap Index
2. Executive Compensation and the Impact of Bill 2
3. Deferral and Variance Account Approvals
4. Cost Allocation and Rate Design
5. Effective Date

[1] Exh. A, Tab 3, Sch. 1, p. 3.

In addressing the proposed Revenue Cap Index, Hydro One responds to each of the three questions that the OEB, in Procedural Order No. 1, has asked the parties to address.[2]

PROPOSED REVENUE CAP INDEX

As described in Exh. A, Tab 4, Schedule 1, Hydro One's application is based on a Revenue Cap Incentive Rate-Setting approach in which the revenue requirement for 2019 is equal to the revenue requirement in year 2018, adjusted for the impacts of Bill 2, and inflated by the Revenue Cap Index ("RCI") set out below. The RCI includes an industry-specific inflation factor and two custom productivity factors, and is expressed as:

RCI = I – X

Where:

- "I" is the Inflation Factor of 1.4%[3], based on a custom weighted two-factor input price index with a 14% labour price index weighting and an 86% non-labour price index weighting; and
- "X" is the Productivity Factor of 0%, which is equal to the sum of Hydro One's Custom Industry Total Factor Productivity measure (0%) and Hydro One's Custom Productivity Stretch Factor (0%).

Hydro One has proposed, for purposes of regulatory efficiency, that the OEB adopt the RCI and associated parameters that were proposed and which are being considered in Hydro One Sault St. Marie LP's ("Hydro One SSM") transmission revenue requirement application (EB-2018-0218)

[2] These were: (i) Is it appropriate to use the rate setting parameters proposed for Hydro One SSM on a preliminary basis, or should another approach be adopted?; (ii) What should be the nature of the proposed variance account? Should it true up to the approved parameters for Hydro One SSM, true up to parameters determined in Hydro One's Custom IR proceeding or some other option?; and (iii) What additional evidence should Hydro One be required to file in its next Custom IR application with respect to the RCI parameters?

[3] As updated in response to LPMA interrogatory #7.

(the “HOSSM Proceeding”). In addition, Hydro One has asked for approval to establish a variance account to track the revenue requirement impact of differences between the proposed Inflation Factor and Productivity Factor in the present Application and those that are approved by the OEB in EB-2018-0218, if any. In the Hydro One SSM proceeding, the RCI parameters are supported by various benchmarking analyses that were prepared by Power System Engineering, Inc. (“PSE”). In Procedural Order No. 1, issued January 24, 2019, the OEB determined that it will not, in the present Application, further test the benchmarking and total factor productivity evidence filed in the Hydro One SSM proceeding. However, the OEB did ask parties to address the three particular questions that are dealt with below.

Notwithstanding the OEB’s direction, BOMA made submissions in respect of Hydro One’s proposed RCI parameters. BOMA submitted that instead of the 14%/86% labour/non-labour split proposed by Hydro One, the OEB should adopt the 30%/70% split established for distributors. Hydro One disagrees. The proposed weighting was developed on the basis of supporting analysis regarding transmission utility costs, which was conducted by PSE and filed in the HOSSM Proceeding. The resulting weighting is reflective of the typical labour/non-labour cost splits that are specific to the transmission industry and is therefore appropriate. BOMA also submitted that the OEB should approve a stretch factor of 0.3%. However, Hydro One’s proposed stretch factor of 0% is based on the empirical results of a Total Cost Benchmarking study of the electricity transmission industry, is reflective of Hydro One’s cost performance and should therefore be approved by the OEB.

Consistent with the OEB’s direction, no other parties proposed any other deviations from Hydro One’s proposed RCI parameters.

OEB Question #1 - Is it appropriate to use the rate setting parameters proposed for Hydro One SSM on a preliminary basis, or should another approach be adopted?

In response to OEB Question #1, OEB Staff, PWU, SEC, LPMA, CCC, Energy Probe and AMPCO each submitted that it is appropriate to use the rate setting parameters proposed for Hydro One SSM on a preliminary basis, and Anwaatin does not oppose doing so.

BOMA submitted that the OEB should extend Hydro One's 2018 rates into 2019, adjusted for the proposed disposition of the deferral account balances. BOMA argues that, since Hydro One just completed a two year cost of service regime, it should have filed a one-year cost of service application while it prepared its 3-year Custom IR proposal. In Hydro One's view, BOMA's submissions on this point should be rejected. BOMA's arguments are strictly about the form of the application and refer to several options (e.g. Annual IR Index and one year cost of service applications) which are not available under the OEB's filing requirements for electricity transmission rate applications. BOMA has not identified any principled basis for its argument against use of the rate setting parameters proposed for Hydro One SSM on a preliminary basis.

In Hydro One's view, the approach taken in the Application is consistent with the OEB's established approach to incentive-based rate setting, where rates are set based on mechanistic adjustments to account for inflationary pressures to costs and to incent utilities towards continuous improvement. Hydro One is seeking to mechanistically adjust its OEB-approved revenue requirement, which was initially established using a bottom-up cost of service approach. The fact that the formulaic approach is proposed through this mechanistic Application rather than as an additional approval sought at the time of the cost of service application should not deter the OEB from approving the Application, which supports an outcome that is aligned with the OEB's desired policy outcomes that are inherent in incentive based rates.

VECC argues that Hydro One's "returns do not, on the face of it, support an upward adjustment to its revenue requirement"[4] and that "regulated returns can be expected in 2018, to once again, exceed the OEB's 2019 target ROE of 8.98%" based on results from Hydro One's fourth quarter reporting, which show peak demand was higher in Q4 2018 as compared to Q4 2017.[5] It argues that Hydro One's shareholder should not benefit from its management's ability to improve returns and also be protected from its management's failure to seek a timely adjustment to its revenue requirement.[6] On this basis, VECC argues that the OEB should adjust Hydro One's revenue requirement by 1.4% (the inflation factor) but only for the period commencing May 1, 2019. In VECC's view, this would avoid the need for any retroactive adjustments and future deferral/variance accounts, and would make Hydro One accountable for the lateness of the filing.[7]

VECC's statements are inconsistent and its argument flawed. VECC claims that Hydro One's returns increased because of its management's abilities, but also that its returns will increase due to peak demand being higher. Higher peak demand is driven by year-over-year variability in load that occurs due to weather. The load forecasts underpinning transmission rates are based on weather-normalized amounts. Actual weather will vary from year-to-year and cause fluctuations in actual versus forecast revenues. It is a risk all utilities are expected to manage. As such, there is no evidence to support VECC's assertion that the achieved ROE for Hydro One's transmission business does not support an upward adjustment to its revenue requirement. In fact, the evidence is to the contrary. Hydro One's achieved ROE in 2017, the first year of its most recent rebasing, was very close to the OEB approved ROE.[8]

Hydro One further notes that the rate setting parameters proposed for approval in the HOSSM Proceeding, and for use in the present proceeding, are based on recommendations arising from benchmarking analyses conducted by PSE. PSE's analysis was based on the costs of Hydro One

[4] VECC, Submissions, para 2.9.
[5] VECC, Submissions, para 2.5.
[6] VECC, Submissions, para 2.6.
[7] VECC, Submissions, para 2.10.
[8] A 25 basis point difference as indicated in response to SEC interrogatory #2.

Networks. Hydro One SSM is therefore proposing in its application to adopt the rate setting parameters of Hydro One Networks. The Hydro One SSM parameters, which Hydro One Networks proposes to use in the present Application, are therefore based on PSE's analysis of the costs of Hydro One Networks. On this basis, Hydro One Networks submits that the first question posed by the Board should be answered in the affirmative.

OEB Question #2 - What should be the nature of the proposed variance account? Should it true up to the approved parameters for Hydro One SSM, true up to parameters determined in Hydro One's Custom IR proceeding or some other option?

As noted, Hydro One has asked for approval to establish a variance account to track the revenue requirement impact of differences between the proposed Inflation Factor and Productivity Factor in the present Application and those that are approved by the OEB in the HOSSM Proceeding, if any.

OEB staff submitted that the variance account should true up to the approved parameters for Hydro One SSM on the basis that this information would be what is "known or knowable" at this point in time. LPMA and AMPCO also submitted that the proposed account should true up to the outcome of the HOSSM Proceeding and not be based on a retroactive adjustment from a future proceeding. PWU and BOMA made no submissions on the nature of the proposed account.

CCC, SEC and Energy Probe submitted that the account should true up to the outcome of Hydro One's Custom IR proceeding so that parties that were not intervenors in the Hydro One SSM proceeding could be afforded the opportunity to review and test the evidence. SEC and CCC submitted that the OEB might consider adopting the evidence from the HOSSM Proceeding to avoid unnecessarily retesting the same issues. Hydro One's submissions in response to these procedural fairness arguments are set out under the heading "Procedural Fairness", below.

Anwaatin states that the OEB's questions regarding the true-up "illustrate the potential complexity and customer confusion of truing up a one-year mechanism". Anwaatin submitted that the OEB should therefore "take a simple and customer-focused approach to addressing both the need for change during the 2019 calendar year and how any such change is undertaken". Similarly, VECC argues that the proposed variance account and true-up proposal is overly complicated, and advocates an approach that avoids the need for the proposed variance account.

It is unclear to Hydro One as to what complexity or customer confusion might arise from its proposal. Once the outcome of the HOSSM Proceeding is known, the resulting calculation would be straightforward and the disposition of balances in the variance account would be applied as an adjustment to Hydro One's revenue requirement consistent with past practice. Customers would continue to pay for transmission based on Uniform Transmission Rates as a dollar per kW charge. Hydro One's proposal is no more complex or confusing for customers than the disposition of a typical deferral or variance account.

Hydro One therefore submits that the proposed variance account, which enables true-up to the outcome of the HOSSM Proceeding, is appropriate. It facilitates an approach that is efficient from a regulatory perspective, does not present undue complexity and the balance will be able to be calculated once the HOSSM Proceeding has concluded.

OEB Question #3 - What additional evidence should Hydro One be required to file in its next Custom IR application with respect to the RCI parameters?

In its response to OEB staff interrogatory #2, Hydro One indicated its intention to file an updated PSE study as part of its next Custom IR application. The updated study would maintain the existing methodology but include a revised forward-looking analysis for the test period reflecting the OM&A and capital spending levels underlying Hydro One's revised business plan at that time. Hydro One submitted its application for 2020 to 2022 transmission rates on March 21, 2019 (EB-2019-0082). That application includes the updated PSE study. As such, in Hydro One's view, the OEB's question is moot and any consideration as to what evidence should be included in that application should be carried out in the context of that application. Hydro One nevertheless responds to the specific submissions made on this question in the present Application.

OEB staff submitted that any evidence submitted by Hydro One should consider the OEB's findings in the HOSSM Proceeding, if the relevant decision is available at the time of filing. SEC and CCC submitted that Hydro One should be required to file whatever evidence it felt was required to support its proposals going forward for the period 2020-2022. AMPCO submitted that Hydro One should be required to file an updated PSE study. As the decision in the HOSSM Proceeding was not available at the time of filing the 2020 to 2022 transmission rate application, Hydro One was not in a position to consider any relevant findings from that proceeding. Moreover, as noted, the 2020 to 2022 application includes an updated PSE study.

Anwaatin requested that the Board require Hydro One to report in its next Custom IR application on: (i) the updated timelines of the Settlement Agreement pilot projects;[9] (ii) the resulting reliability in the affected communities following completion of the pilot projects; (iii) the costs of the project and traditional wires alternatives; and (iv) any other parameters that the Board views relevant to its ongoing consideration of productivity, inflation, and stretch factors. Hydro One does not agree that it would be appropriate for Hydro One to report on these aspects as part of its next Custom IR transmission rate application. As noted in its response to Anwaatin interrogatory #1, the battery storage system pilot project from the Settlement Agreement refers to a distribution system investment and, as such, has no impact on Hydro One's transmission revenue requirement. The requested information will not be relevant to Hydro One's next transmission revenue requirement application and the filing of such information should therefore not be required by the OEB.

Energy Probe submitted that in addition to the evidence required to support its Custom IR proposal, Hydro One should file a Transmission System Plan that covers the Custom IR term and identifies significant capital expenditure needs. Energy Probe submitted that Hydro One should also file

[9] Anwaatin refers to the Settlement Agreements in EB-2017-0335 and EB-2017-0049.

evidence on how its Total Costs and Reliability benchmark against other transmitters. Moreover, VECC submitted that Hydro One in its next transmission rate application should respond to all of the OEB directions identified in VECC Interrogatory #1. Hydro One notes that the additional information identified by each of Energy Probe and VECC has already been provided as part of the Custom IR application which was filed by Hydro One on March 21, 2019.

PWU, BOMA and LPMA made no submissions on the OEB's question #3.

Procedural Fairness

A number of intervenors, including CCC, SEC and BOMA, commented on the fairness of having the RCI parameters determined in the HOSSM Proceeding when not all of the intervenors in the present Application were also intervenors in the HOSSM Proceeding. Hydro One believes the OEB is in the best position to determine and conduct a fair and efficient process, and that the process followed and the approach proposed in the present Application are appropriate. It avoids the re-testing of the same evidence that is before the OEB in the HOSSM Proceeding, allows for a timely adjustment to Hydro One's transmission revenue requirement for 2019, provides an opportunity for the RCI parameters to be tested, and ensures that customers and Hydro One are kept whole.

It is also important to recognize that the issues relating to the RCI parameters have been thoroughly tested in the HOSSM Proceeding, including through pre-filed evidence, competing expert evidence, interrogatories and a 2-day technical conference. The record is therefore comprehensive and complete. Moreover, the participation of those who are involved in the present proceeding but not the HOSSM Proceeding would not have materially changed the record. In particular, PWU is an intervenor in both proceedings and consumer interests are well represented in the HOSSM Proceeding by AMPCO, Energy Probe, VECC and SEC. While intervenors such as CCC, BOMA and LPMA appear regularly before the Board, it was their choice to not participate in the HOSSM Proceeding. This is not an appropriate reason to disregard the results of that proceeding or to encourage regulatory inefficiency by providing an opportunity to consider the same issues in separate proceedings.

BILL 2 – EXECUTIVE COMPENSATION

In this proceeding, Hydro One proposes to adopt the findings of the OEB in EB-2017-0049 in respect of its interpretation of the *Hydro One Accountability Act, 2018* and section 78(5.0.2) of the *Ontario Energy Board Act*. Hydro One's submissions in this proceeding are consistent with its proposal in EB-2017-0049.

On March 7, 2019, the OEB issued its decision in EB-2017-0049 and found that Hydro One's interpretation of section 78(5.0.2) of the *OEB Act* was reasonable. The OEB also accepted Hydro One's proposal to exclude remaining executive compensation costs of its Executive Leadership Team (ELT) from its revenue requirement.

This Application and the underlying revenue requirement are consistent with the company's approach in EB-2017-0049 in respect of the *Hydro One Accountability Act, 2018* and section 78(5.0.2) of the *OEB Act*, and the proposed revenue requirement therefore does not need to be modified on this basis.

However, very minor modifications are made to the proposed revenue requirement to reflect a directive issued February 21, 2019 (the "Directive"). In the Directive, the Provincial government established compensation limits for Hydro One's Chief Executive Officer ("CEO"), other executives and the Board of Directors of Hydro One Limited and its subsidiaries.[10] Hydro One has, accordingly, adopted a new executive compensation framework which is consistent with the Directive and is reflected in the modifications made in this Application to Hydro One's proposed revenue requirement, as follows:

- No other executive's total compensation will exceed 75% of the CEO's compensation;

[10] The directive limited compensation for Hydro One's CEO, limited compensation for other executives to 75% of the CEO's maximum direct compensation, capped annual increases to executive salaries at the Ontario CPI, and limited the compensation of Board members to $80,000 annually and the Chair of the Board to $120,000 annually.

- Compensation factors will be adjusted in future years at the RCI rate; and
- Compensation for the Board of Directors has been decreased to the levels indicated in the Directive.

As compensation for the CEO and ELT has already been removed from the Application, the only implications of the Directive for the Application are with respect to the revenue requirement impact of the changes to Board of Director costs. Hydro One has determined that the Directive requires a reduction in the total amount of Board of Director costs by $200K as compared to the amount reflected in the Application. Of this, approximately $50K is allocated to OM&A and approximately $150K is allocated to Capital. The corresponding revenue requirement impact of the Directive, after escalating the adjusted 2018 costs by the 1.4% Inflation Factor, is negligible at approximately $56K.

DEFERRAL AND VARIANCE APPROVAL

Hydro One requests disposition of a $37.6 million credit balance in the regulatory accounts as detailed in Table 1 below. The disposition balance is based on actual audited Regulatory Account values as at December 31, 2017, plus forecast interest accrued in 2018, less any amounts approved for disposition in 2018 by the OEB in the EB-2016-0160 proceeding for rate years 2017 and 2018. Hydro One proposes to dispose of this balance as an offset to its revenue requirement over a one-year period, effective January 1, 2019.

Table 1 - Transmission Regulatory Accounts Requested for Disposition ($ Millions)

Description	Forecast Balance as at Dec 31, 2018
Excess Export Service Revenue	(6.5)
External Secondary Land Use Revenue	(16.0)
External Station Maintenance, E&CS and Other External Revenue	(2.1)
Tax Rate Changes	0.4
Rights Payments	1.6
Pension Cost Differential	(13.0)
Long-Term Transmission Future Corridor Acquisition and Development	0.0
LDC CDM Variance Account	(0.8)
External Revenue – Partnership Transmission Projects Account	(0.0)
OEB Cost Differential Account	(1.3)
Total Regulatory Accounts Seeking Disposition	**(37.6)**

Exhibit Reference: A-6-1.

Additionally, Hydro One is requesting approval for a modification to the Accounting Order for the OPEB Cost Deferral Account as approved in EB-2017-0338. The requested modification would allow Hydro One to continue to track the impact of the Financial Accounting Standards Board Account Standard Update (ASU) 2017-07 (“ASU 2017-07”) until the time of Hydro One’s next rebasing application. This account currently records all elements of net periodic benefit cost other than the service cost that would have been classified as capital prior to the adoption of ASU 2017-07. No parties objected to this request.

As part of its response to OEB Staff Interrogatory #6, Hydro One indicated that it will not be tracking any variance for 2019 in the OEB Cost Assessment Variance Account and the account is no longer being requested for continuation for 2019.

Hydro One is also requesting approval for a variance account to track the revenue requirement difference between the proposed RCI parameters and the final parameters that will be approved by the OEB in the HOSSM Proceeding that is currently before the OEB. This is further discussed under the RCI section, above.

VECC agreed with the final disposition balance notwithstanding the fact that account 1508-OEB Cost Differential Account does not meet the materiality threshold. Hydro One notes the OEB stated as part of its decision in EB-2017-0049 that:

> …materiality thresholds for deferral and variance accounts in the OEB's Filing Requirements for Distribution Rate Applications – Chapter 2 Cost of Service are for the purposes of determining whether a new account will be established. The OEB will therefore not use the materiality thresholds for determining whether balances recorded in an existing account will be disposed.[11]

OEB staff, in its submissions, takes no issue with the proposed disposition amount. However, OEB staff takes issue with the remaining balance in the Transmission Foregone Revenue Deferral Account, which Hydro One is not proposing to dispose of in the Application. The account was established in Hydro One's 2017 and 2018 transmission rate application (EB-2016-0160) to record the difference in revenues between interim 2017 rates and the final approved 2017 rates. Hydro One indicated that it booked and will be booking in the account the difference between approved revenues and the revenues it would have had a right to recover based on its position in its Review Motion relating to tax savings in that proceeding. This is because the Review Motion, if successful, would give rise to further differences between the interim 2017 rates and the final rates reflecting the successful Review Motion. Hydro One's intention has been to facilitate recovery of such differences if and when it was successful on the Review Motion. Although the Review Motion was

[11] EB-2017-0049, Decision and Order, May 7, 2019, p. 168

denied by the OEB on March 7, 2019, Hydro One plans to appeal the OEB's decision[12]. As such, the company's purpose for maintaining the account remains. It is therefore Hydro One's intention to maintain the account pending the final disposition of its appeal so as to facilitate any future recovery if and when the appeal is successful.

AMPCO argues that since Hydro One will present audited balances for December 31, 2018 in its next Transmission revenue requirement application, the In-Service Capital Additions Variance Account should continue into 2019. Similarly, BOMA argues that December 31, 2018 balances need to be provided, or at least the balance in the In-Service Capital Addition Variance Account, prior to the OEB rendering a decision in this case. In Hydro One's view, these submissions reflect several misunderstandings as to what is being proposed in the Application and should therefore be rejected. First, Hydro One has not asked to discontinue the In-Service Capital Additions Variance Account and, as such, it would continue to exist in 2019. Second, the Application is based on 2017 audited account balances, which were provided in Exh. A, Tab 6, Schedule 1. Third, it is Hydro One's intention that the account will continue until such time that the 2018 audited balances have been presented and disposed of through Hydro One's next transmission rebasing application. Fourth, Hydro One is not proposing to book any new transactions to this account in 2019 other than interest amounts.

SEC has taken no position in regards to the disposition balance proposed by Hydro One. However, for different reasons than AMPCO and BOMA, SEC argues that the In-Service Capital Additions Variance Account should be extended to 2019. SEC argues that this is needed to ensure that the impact in 2019 of any variance in 2017 and 2018 is captured and not to record any variances in 2019 in-service additions. In Hydro One's view, SEC's submission should be rejected. The purpose of the account is to record differences in actual in-service capital additions relative to forecast in-service capital additions. The account was established in the context of a two-year cost

[12] As noted in press release issued on March 26, 2019. Available online at: http://hydroone.mediaroom.com/2019-03-26-Hydro-One-seeks-to-review-and-vary-pension-findings-in-OEB-decision-and-pursues-Ontario-Divisional-Court-appeal-on-the-deferred-tax-asset-decision

of service application in which Hydro One provided forecasts of its in-service capital additions for each year. To the extent actual in-service additions for those years differed from forecast, amounts were recorded in the account. In contrast, the present Application is under an incentive-based framework and does not include any forecasts of in-service capital additions. Under this framework, costs are decoupled from rates, which are instead adjusted only by the RCI parameters. As such, SEC is effectively trying to adjust the RCI by a factor other the Inflation Factor and the Productivity Factor. This is neither typical nor appropriate.

COST ALLOCATION AND RATE DESIGN

Revenue Offsets

Hydro One has proposed to not adjust the Revenue Requirement offsets (External Revenue, Wholesale Meter Service and Exit Fee (“WMS”) Revenue and Export Transmission Service (“ETS”) Revenue) by inflation because a significant portion of these other revenue components are driven by rates that are not changing and service volumes that are not impacted by inflation. The largest component is ETS Revenue, for which a variance account has been approved to track any differences between actual and forecast export revenues.[13]

SEC, CCC and BOMA submitted that the RCI parameters should apply to the Revenue Requirement offsets. SEC submitted that the revenue offsets should increase by inflation, minus a productivity and stretch factor, and that cherry-picking the components that are escalated negates that portfolio effect.[14] CCC submitted that this approach would be consistent with how Price Cap Indexes are applied, and that it is unfair to only inflate the low voltage switchgear credit.[15] Though it referenced no supporting authorities, BOMA argued that there is a well-established regulatory principle that the utility cannot selectively apply these parameters.[16]

[13] Response to VECC interrogatory #13.
[14] SEC Submission p 3.
[15] CCC Submission p 2.
[16] BOMA Submission p 5.

OEB staff, in its submissions, states that it supports Hydro One's proposed treatment of other revenues, including its proposal to keep other revenues at their 2018 values.[17] OEB staff noted that the largest portion of the other revenues, ETS revenue, is driven by the ETS rate, which will not change until such time as another cost allocation study demonstrates that the rate is no longer appropriate. Moreover, OEB staff notes that inflating External and WMS revenues by an RCI of 1.4% will not have an impact on UTRs.

Although OEB staff supports Hydro One's proposed treatment of other revenues, including in particular its proposal to keep other revenues at their 2018 values, OEB staff disagrees with the manner in which Hydro One has applied the RCI relative to other revenues. Whereas Hydro One proposes to adjust its 2018 approved revenue requirement (after reflecting the Bill 2 impacts) by an RCI of 1.4% to determine the total 2019 revenue requirement, and then to adjust that total by removing other revenues to derive the rates revenue requirement, OEB staff submits that it would be more appropriate if Hydro One applied the RCI of 1.4% after adjusting for other revenues.

In Hydro One's view, it would not be appropriate to apply the RCI adjustment to the rates revenue requirement, i.e. after excluding other revenue offsets. Although doing so would be consistent with the approach taken under Price Cap IR for Distribution as suggested by OEB staff and some of the intervenors, the setting of Transmission rates is fundamentally and materially different from setting Distribution rates. This is because determination of the Transmission Rates Revenue Requirement includes components that in Distribution are <u>not</u> part of the Distribution Rates Revenue Requirement, namely: Regulatory Assets and Foregone Revenue. These items are handled via riders in the setting of Distribution rates and, as such, are <u>not</u> subject to a Price Cap adjustment. In addition, unlike Distribution, a significant portion of the remaining Transmission revenue offsets, namely ETS Revenue and WMS Revenue, are not impacted by inflation (as recognized by OEB staff). Therefore, applying an RCI adjustment at the Transmission Rates Revenue Requirement level would have the effect of overstating the revenue offset components for 2019 and thereby result

[17] Staff Submission p 14.

in an adjustment to Hydro One's Transmission Revenue Requirement, which would under-recover the funds Hydro One requires to run its Transmission business in 2019.

Hydro One is not "cherry-picking" the items to which RCI is applied, as suggested by SEC. Rather, there is a sound regulatory basis for how each of the revenue offsets is to be treated. Hydro One's proposal to adjust the Low Voltage Switchgear ("LVSG") component of the Rates Revenue Requirement stems from the fact that the LVSG credit amount is directly dependent on the portion of total revenue requirement that is assigned to the Transformation Connection pool. Given that Hydro One's total revenue requirement is being adjusted by RCI, this would also increase the Transformation Connection pool revenue requirement and therefore it is appropriate that the LVSG credit to customers is also increased.

LPMA submitted that RCI parameters should apply to ETS Revenue with the impact on revenues tracked in the existing variance account, and that External Revenue and WMS Revenue should be kept at the 2018 approved values. LPMA stated that there is no logic in increasing UTRs to take into account inflation less productivity and then to not apply the same index result to another rate, the ETS rate. LPMA noted that transmission costs to Ontario customers will increase, while there would be no increase for export service customers.[18] LPMA therefore requested that Hydro One update Table 1[19] in the draft rate order.[20]

Hydro One submits that LPMA is mistaken in suggesting that there is no logic in treating the ETS rate differently from the UTRs. The ETS rate has always been treated independently of any changes to UTRs, as evidenced by the fact that while UTRs have changed every year since 2006 to reflect the annual changes in revenue requirement and load, the ETS has remained constant for significant periods: $1.00/MWh from 2006 to 2009, $2.00/MWh from 2010 to 2014, and $1.85/MWh from 2015 to the present. The currently approved ETS is a value agreed to through

[18] LPMA Submission p 3-4.
[19] LPMA Submission p 5 refers to Exhibit A-7-1, which was updated in response to Board staff interrogatory #3.
[20] LPMA Submission p 5.

settlement, informed by cost allocation, and approved by the Board based on evidence submitted in the context of a full cost-of-service application. The ETS rate has never changed in lockstep with UTRs, and it would be inappropriate to adjust the ETS rate within the context of an RCI approach for defining the 2019 transmission revenue requirement.

Cost Allocation

In response to Board staff interrogatory 3, Hydro One set out its proposed cost allocation methodology for determining the 2019 rates revenue requirement by rate pool, based on the approach recommended by OEB staff. In their respective submissions, OEB Staff, AMPCO, VECC and LPMA expressed support for the proposed methodology.[21] Moreover, OEB staff and LPMA submitted that there should not be any update to the billing determinants under a revenue cap and that the proposed charge determinants, as listed in Table 3,[22] should be approved.[23] Hydro One therefore submits that its proposed cost allocation methodology for determining the 2019 rates revenue requirement by rate pool should be approved.

EFFECTIVE DATE

Hydro One filed the Application October 26, 2018, and requested an effective date of January 1, 2019. The form and timing of the Application arise from exceptional circumstances largely outside of its management's control. Some parties argue that the effective date should be later than January 1, 2019, and have proposed effective dates ranging from March 1, 2019 (OEB Staff) to one month after the final rate order (BOMA). PWU argues that a January 1, 2019 effective date is reasonable because of the straightforward and mechanistic nature of the Application, because it took nearly three months for the OEB to issue PO1, and because there are only two months between the

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[21] OEB staff Submission p 15, LPMA Submission p 6, VECC Submission p 5 and AMPCO Submission p 3.
[22] Exhibit A-3-1, p 8.
[23] OEB staff Submission p 14 and LPMA Submission p 3-4.

issuance of PO1 and Hydro One's reply submissions.[24] For the following reasons, Hydro One maintains its submission that the appropriate effective date is January 1, 2019:

- The Application is mechanistic in nature and has been heard in writing, requiring less processing time than a typical cost of service or Custom IR application (only 2 months from PO1 to reply submissions);
- Hydro One experienced significant organizational change, including appointment of a new Board of Directors in August 2018, representing exceptional circumstances out of its management's control, which delayed internal approval to file the application (Exh A-3-1); and
- Hydro One filed its application as soon as reasonably possible after receiving such approval.

CONCLUSION

Based on the foregoing, it is Hydro One's submission that its proposed 2019 transmission revenue requirement is reasonable and that the Application should be approved as filed, and as further proposed by the applicant during the proceeding.

All of which is respectfully submitted this March 28, 2019.

HYDRO ONE NETWORKS INC.

ORIGINAL SIGNED BY
FRANK D'ANDREA

By: Frank D'Andrea
Vice President, Chief Regulatory
Officer, Chief Risk Officer

[24] PWU Submissions, para 13.