



BY EMAIL and RESS

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April 8, 2019
Our File No. 20170049

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
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Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2017-0049 – Hydro One Distribution – Draft Rate Order

We are counsel for the School Energy Coalition. We are writing this letter because we are concerned that the draft rate order provided by the Applicant lacks material information and documentation necessary for the Board and the parties to consider it, contrary to the Board's direction.

SEC wrote to Hydro One on March 12th, to ensure that the information and documentation necessary, with respect specifically to the question of costs that should not be borne by legacy customers, would be provided. A copy of that letter is attached, together with Hydro One's initial response. In the draft DRO filed on Friday, however, Hydro One has refused to provide the information requested.

SEC wishes to be able to make thorough and thoughtful submissions to the Board on the DRO related to this question, but is unable to do so, because despite early warning of the information reasonably required, Hydro One has not provided it. Due to the

standard problem of information asymmetry, if Hydro One does not provide it, SEC, other parties, and the Board do not have access to that information.

SEC therefore requests that the Board order Hydro One to provide the additional information required, in a timely manner, so that the DRO process in this case is not delayed by Hydro One's resistance.

The Issue

The issue raised by SEC in its March 12th letter is the amount and calculation of the costs to be removed from the legacy customer revenue requirement, when the deferred rebasing periods end for the Acquired Utilities. Clearly, setting rates for the legacy customers requires that the costs associated with serving the acquired customers be removed. This is apparent from the Board's Decision, where the Board said [at page 164]:

"The determination that Hydro One is to absorb revenue shortfalls associated with its cost to operate the Acquired Utilities eliminates the negative impact that Hydro One's rate proposal would have had on its customers."

Hydro One's rate proposal was that the incremental costs of the acquired customers would be allocated to them, but that only part of the shared costs of those customers would be allocated to them. Certain adjustments to those shared costs were proposed, with the remainder of those costs left in the rates of the legacy customers. The Board expressly rejected that approach.

SEC realized that Hydro One might seek to deduct from the costs to serve the legacy customers an amount of costs less than the costs to serve the acquired customers as their deferred rebasing periods expired. We wrote our March 12th letter to ensure that, if the amount to be deducted was in dispute, the DRO would contain full information so that parties could make submissions on that dispute, and the Board could make an informed decision.

The Hydro One Interpretation

The five year deferred rebasing periods for the three Acquired Utilities, as ordered by the Board in the respective MAADs decisions, ended¹:

Norfolk - September 7, 2019
Haldimand – June 30, 2020
Woodstock – October 30, 2020

¹ Exhibit A. Tab 7, Schedule 1, p. 9.

Hydro One proposed to move most of the customers of the Acquired Utilities to new rate classes, and a few to existing rate classes, as of January 1, 2021. This effectively extended the deferred rebasing period for all of the acquired customers, i.e. extending the period those customers benefitted from lower rates, but also extending the period that the legacy customers bore costs properly attributable to the acquired customers. No party objected to that small extension of the deferred rebasing period, presumably because it was relatively short, and the long-term benefits of the simplification would be worthwhile for all customers.

SEC notes that, during the deferred rebasing period, as Hydro One freely admits², all of the shared costs to serve the acquired customers were borne by the legacy customers, but the reduction in incremental costs to serve those customers as a result of the acquisitions accrued to the benefit of the shareholders. This is an intentional Board policy, designed to compensate shareholders for the costs of distributor consolidation.

In this Decision, the Board rejected the Applicant's proposal to use a special form of cost allocation to allocate costs to the acquired customers. On an overall basis, the Board described its reason for so doing as [p. 162]:

"Hydro One's cost allocation evidence indicates that in the absence of adjustment factors, Hydro One's long term costs to serve the Acquired Utilities are higher than the costs of those previous utilities. This is in direct contradiction to the evidence relied on in its acquisition proposals."

The cost allocation the Board was referring to was the allocation by Hydro One that included both incremental and shared costs.

The Board also said, with respect to the adjustment factors [p. 161-2]:

"As SEC argued, Hydro One's rate proposal is based on a snapshot of the existing asset base in the acquired service area. The OEB agrees and based on Hydro One's failure to demonstrate that its costs are the same or lower in its evidence, finds that the proposal will result in one of the two following negative outcomes:

- a) In the absence of recalibration of the adjustment factors, an undue subsidy from Hydro One's legacy customers would be required.*
- b) In the situation where the calibration of the adjustment factors is commensurate with asset renewal at Hydro One's higher costs, harm in the form of relatively higher rates to the customers of the Acquired Utilities would need to be imposed."*

² For example, in EB-2018-0270 (Orillia #2) and EB-2018-0242 (Peterborough). This does not appear to be in dispute as it is the underlying foundation for all of Hydro One's cost allocation evidence in this proceeding as well.

Based on its conclusion that Hydro One was not able to serve the acquired customers at or below status quo costs, the Board ordered as follows [p. 164]:

“Hydro One’s rates proposal in this proceeding does not reflect the OEB’s determinations in its acquisition decisions. Hydro One had the opportunity to inform the OEB prior to completing its approved transactions if it did not anticipate being able to deliver on the OEB’s clear expectations. The OEB finds that any shortfall in revenue requirement that results from Hydro One’s costs being higher than its current and future approved revenues associated with the Acquired Utilities shall be absorbed by Hydro One and not form any part of the overall revenue requirement.

Hydro One may apply to the OEB for a rate adjustment mechanism under the Price Cap IR approach to be applied to the current base rates for the Acquired Utilities, to take effect at the end of the respective deferred rebasing periods.

The determination that Hydro One is to absorb revenue shortfalls associated with its cost to operate the Acquired Utilities eliminates the negative impact that Hydro One’s rate proposal would have had on its customers.”

Hydro One has interpreted the Board’s decision to be that the deferred rebasing period for the Acquired Customers will continue indefinitely. This would have two unusual results:

- **Over-Allocation of Costs to Legacy Customers.** As noted earlier, during the deferred rebasing period the legacy customers bear the shared costs to serve the acquired customers, so under the Hydro One interpretation that would continue into the future.
- **Increase in Deferred Rebasing Benefit to Shareholders.** Further, during the deferred rebasing period the difference between revenues from the acquired customers, and incremental costs to serve those customers (which is always lower), accrues to the benefit of the shareholders. This would also, on the Hydro One interpretation, continue into the future for an indefinite period.

Information and Documentation Included in the DRO

Clearly Hydro One and SEC disagree on the proper interpretation of the Board’s decision in this respect, and in submissions on the DRO we would have expected to argue in favour of full deduction of costs (including all relevant shared costs) to serve the acquired customers from the revenue requirement to serve the legacy customers, commencing in the case of each Acquired Utility “at the end of the respective deferred rebasing periods”.

However, in order to make those submissions, SEC (and the Board, and other parties) need to have full information. SEC’s letter of March 12th was sent as a courtesy to

Hydro One, in order to ensure that they were aware of the information and documentation we would need in compliance with the Board's following directive [p. 177]:

"The OEB directs Hydro One to file a draft rate order reflecting the OEB's findings in this Decision and Order complete with supporting material, including [various items specified, and]... any other documentation that would assist intervenors, OEB staff and the OEB in consideration of the proposed draft rate order."

The specific information SEC requested is detailed in our letter, attached. In essence it is comprised of a) the costs to be excluded from revenue requirement for the acquired customers, b) the basis of those costs if the allocation methodology or assumptions are different from those applied to legacy customers, and c) calculation of the amounts expected to be borne by shareholders after each deferred rebasing period, as contemplated by the Board's order.

In refusing to provide that information, Hydro One focuses on the fact that the Board did not order cost-based rates for the acquired customers, but rather a price cap approach. Further, Hydro One emphasizes that the Board did not approve the proposed cost allocation to the Acquired Utilities, so there is no basis to allocate costs between legacy and acquired customers.

In taking the approach they have, Hydro One has, with respect, missed the point. The immediate issue is not the allocation of costs to the acquired customers for rate-making purposes. Rates for those customers will be set, on the dates their deferred rebasing periods ended, based on PCI.

This is not about rates for the acquired customers. This is about rates for the legacy customers. The issue is the costs that should not be borne by the legacy customers. As soon as the deferred rebasing period is over for each Acquired Utility, the costs to serve those customers are no longer to be borne by the legacy customers.

It would appear that whether costs to serve the acquired customers have to be excluded from revenue requirement in determining rates for legacy customers is not in dispute. The only issue appears to be the amount of such costs to be excluded.

Hydro One has taken the view that the costs to be excluded from the legacy customers are just incremental costs³:

"Revenue requirement associated with the rate base, incremental OM&A, incremental capital, and working capital components for the Acquired Utilities has been removed in 2021 and 2022."

³ Draft Rate Order, p. 7.

Nowhere in the DRO package are these amounts detailed. Hydro One has taken the view that, since those incremental costs for acquired customers are not included in 2018 revenue requirement for legacy customers, and revenue requirement for legacy customers for subsequent years is determined based on a formula, necessarily the revenue requirement in subsequent years excludes the incremental costs for the acquired customers.

Of course, the Hydro One approach assumes their interpretation of the Decision, despite the apparently unusual implications of that interpretation. The problem with this is not that they are wrong. The problem is that lack of information makes it difficult for other parties, or the Board, to present any better interpretation.

SEC does have some information with respect to the full costs related to the acquired customers. For example, I.56.SEC.96 has detailed responses to questions about costs to serve acquired customers. There was also much information on cost allocation presented during the oral hearing, and elsewhere in the record.

All of this information is deficient for DRO purposes in three ways: a) it does not reflect the Board's Decision in terms of costs approved for recovery, b) it assumes that the deferred rebasing period for each of the Acquired Utilities ends December 31, 2020, which the Board specifically did not approve, and c) it does not include the costs to serve the acquired customers who were not included in the proposed new classes, but were folded into existing legacy classes.

Hence our March 12th letter, requesting detailed information consistent with the Board's Decision.

Request for an Order

It is clear that, consistent with the Decision, Hydro One will have some costs in the 2018-2022 period which should not, and will not, be borne by legacy customers because they are costs to serve the acquired customers. Some of those excluded costs will be covered by the acquired customers in their formula rates, and some will be borne by the shareholders. The Board will have to determine what those costs are, in order to ensure that rates for the legacy customers are just and reasonable, and the legacy customers do not have costs to serve the acquired customers included in their rates.

SEC notes that it is not necessary for the Board to determine, now, the issue of the proper costs to be excluded from the legacy customers' revenue requirement, and that is not the purpose of this letter. Parties will likely have a range of submissions on that issue, and the differences are substantial.

However, in order for the Board to make that determination, and in order for the parties to make submissions, the parties and the Board require information. That is the purpose of this letter.

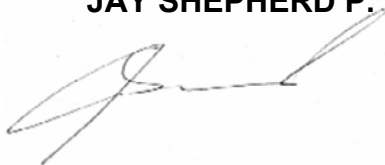
SEC therefore requests that the Board order Hydro One to refile the DRO with the information requested by SEC in its letter of March 12th.

Further, in order to ensure that the initial refusal of Hydro One to provide this information does not delay the DRO process, SEC requests that the Board make this order now, rather than wait until submissions are filed with respect to this incomplete DRO. If this information is provided this week (which should be possible), then SEC believes that the current DRO schedule, with intervenor and OEB Staff submissions on April 15th, can be maintained.

Conversely, if the Board's order to provide this information is not until after the submissions period, we believe the result will be a delay of at least a month in the completion of the DRO process and the finalization of Hydro One's rates. In fact, it could be much longer, if the dispute over what costs to exclude from legacy revenue requirement first has to be argued and decided, then Hydro One has to file additional information, and then that has to be reviewed and perhaps disputed as well. Extended delays in getting to final rates in the end only hurt the customers.

All of which is respectfully submitted.

Yours very truly,
JAY SHEPHERD P. C.



Jay Shepherd

cc: Wayne McNally, SEC (email)
Interested Parties



BY EMAIL and RESS

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March 12, 2019
Our File No. 20170049

McCarthy Tetrault LLP
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Attn: Gordon Nettleton

Dear Mr. Nettleton:

Re: EB-2017-0049 – Hydro One Distribution – Information for DRO

We are writing on behalf of our clients in this matter, the School Energy Coalition to provide input on the information your client Hydro One is to provide in its draft rate order package, due to be filed April 11, 2019.

In its Decision, the Board commented as follows (at page 177):

“The OEB directs Hydro One to file a draft rate order reflecting the OEB’s findings in this Decision and Order complete with supporting material, including [various items specified, and]... any other documentation that would assist intervenors, OEB staff and the OEB in consideration of the proposed draft rate order.”

We are writing this letter to request that you provide specific types of information and calculations in the draft rate order with respect to two aspects of the Decision.

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Capital Expenditures to In-Service Additions

In the Decision, the Board said (at page 77) Hydro One was:

“...directed to propose a preliminary annual distribution of the capital reduction over the term of the Custom IR plan as part of the draft rate order process of this proceeding.”

SEC requests that Hydro One ensure that it provides with the draft rate order a detailed explanation of how the proposed distribution of the capital expenditure reductions has been then translated into in-service addition reductions for each year. That is, for each category of capital expenditures, what has been adjusted, and how has that flowed through to in-service additions (for that or any other year) and therefore revenue requirement?

In proving this information, it would be helpful if Hydro One could reconcile the reductions with the capital expenditure/in-service additions ratios provided in Undertaking JT 3.4.

Providing this information will help avoid much of the confusion that occurred during the draft rate order process for Hydro One's most recent Hydro One Transmission proceeding (EB-2016-0160).

Cost Allocation and Acquired Utilities

The Board ordered, with respect to the Acquired Utilities, that Hydro One set their rates at the end of their respective deferred rebasing periods using the Price Cap IR method.

The Board went on to say (at page 164):

“The OEB finds that any shortfall in revenue requirement that results from Hydro One's costs being higher than its current and future approved revenues associated with the Acquired Utilities shall be absorbed by Hydro One and not form any part of the overall revenue requirement.

Hydro One may apply to the OEB for a rate adjustment mechanism under the Price Cap IR approach to be applied to the current base rates for the Acquired Utilities, to take effect at the end of the respective deferred rebasing periods.

The determination that Hydro One is to absorb revenue shortfalls associated with its cost to operate the Acquired Utilities eliminates the negative impact that Hydro One's rate proposal would have had on its customers.”

Since the Board has not approved the various adjustments proposed by Hydro One for the end of deferred rebasing, it appears to us that the rates for all customers will be set for those years (2020-2022) in this DRO process.

Of course, in order to do this costs related to serving the customers of the Acquired Utilities must be excluded from the cost allocation model applicable to the legacy customers for the years after deferred rebasing. Although the rates themselves are decoupled from costs, the Board contemplates that the costs to serve them will still be allocated to them. If those costs exceed the revenue from the formula rates, the difference will be borne by the shareholders.

Prior to the end of the deferred rebasing period, the costs excluded from allocation to the legacy customers are just the incremental costs to serve the Acquired Utilities. This provides Hydro One with a benefit under the MAADs policy. That will, of course, change when the deferred rebasing periods end.

As Hydro One has pointed out in its evidence (and in many other proceedings), there are two categories of costs to serve the Acquired Utilities: incremental costs, and shared costs. That is, there are the costs that Hydro One would not have were it not for the Acquired Utilities, and then there is the Acquired Utilities' normal share of the costs incurred to serve all customers.

Clearly the costs allocated to the Acquired Utilities (i.e. excluded from costs allocable to legacy customer classes) will be of some importance in establishing both the rates for legacy customers, and the amount of shortfall to be borne by the shareholders.

To assist SEC, the Board, and others, in reviewing the DRO and the proposed rates for the later years, we request you provide the following:

- A full cost allocation model for each of the five years rates are being set, showing the amounts allocated to the Acquired Utilities as a group, and details of the basis of that allocation. For the deferred rebasing years, that will be incremental costs, and for the later years that will include their share of shared costs.
- To the extent, if any, that the allocation to the customers of the Acquired Utilities is done on a different basis from the allocation to the legacy customers (other than in the deferred rebasing years), full details on the difference, including the impact, and the rationale for that difference. While we believe that the Board expects the cost allocation for customers in the Acquired Utilities after deferred rebasing to be identical to that for the legacy customers, if Hydro One believes otherwise we are requesting that any deviations be flagged, quantified, and fully explained.
- A full calculation of the amount of its distribution revenue requirement that Hydro One expects will be borne by shareholders in each of 2020, 2021 and 2022 as a result of setting the rates for the Acquired Utilities on the basis of Price Cap IR. This should include the forecast rates and revenues for each of the current rate classes of each of the Acquired Utilities, the costs allocated to them, and the

calculated difference for each class in each year. If it is possible to calculate the forecast impact on Hydro One's annual ROE for each year, that would also be helpful.

As with all models, we would ask that all calculations be provided in live Excel spreadsheets, to save time in the DRO review process.

Conclusion

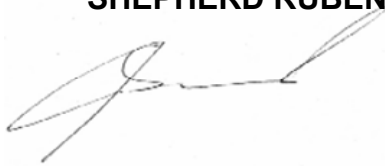
SEC believes that, if Hydro One provides the above categories of information, that will greatly assist the Board and the parties in reviewing the draft rate order in a timely and efficient manner.

We have copied this to all parties, and to the Board, in case others wish to provide input on aspects of the DRO package that Hydro One should consider.

Thank you for your assistance.

Yours very truly,

SHEPHERD RUBENSTEIN PROFESSIONAL CORPORATION



Jay Shepherd

cc: Ontario Energy Board (RESS)
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Wayne McNally, SEC (email)
Interested Parties (email)



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Gordon M. Nettleton
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March 13, 2019

VIA RESS AND COURIER

Shepherd Rubenstein Professional Corporation
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Attention: Jay Shepherd

Dear Mr. Shepherd:

**RE: Hydro One Networks Inc. ("Hydro One")
EB-2017-0049 - Hydro One 2018-2022 Distribution Rates Application
Information for DRO**

Thank you for your letter of March 12, 2019.

I can advise that Hydro One is in the process of preparing its DRO filing in satisfaction of the Board's Directions found at page 177 of the March 7, 2019 decision. As part of this submission, Hydro One will consider those suggestions set out in your letter that are viewed to be consistent with the Decision and its Directives.

If differences of opinion arise in this regard, the comment process established in the Board's Order (page 178 of the Decision) appears to be the intended forum for such issues to be raised.

Yours very truly,

McCarthy Tétrault LLP

Per:

Gordon M. Nettleton

cc: All Parties – EB-2017-0049