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BY EMAIL

July 5, 2019

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

Dear Ms. Walli:

Re: Hydro One Networks Inc.

Application for Approval of Attribution of Construction Costs of Supply to Essex County Transmission Reinforcement
OEB Staff Submission
OEB File No. EB-2019-0120

In accordance with Procedural Order No. 1, please find attached the OEB Staff Submission for the above proceeding. This document has been sent to Hydro One Networks Inc. and to all other registered parties to this proceeding.

Hydro One Networks Inc. is reminded that its Reply Submission is due by July 12, 2019, should it choose to file one.

Yours truly,

Original Signed By

Tina Li
Project Advisor, Rates Major Applications

Encl.

Application for Approval of Attribution of Construction Costs of Supply to Essex County Transmission Reinforcement

Hydro One Networks Inc.

EB-2019-0120

OEB Staff Submission

July 5, 2019

1 INTRODUCTION AND SUMMARY

Hydro One Networks Inc. (Hydro One), a licensed rate-regulated transmitter, filed an application with the Ontario Energy Board (OEB) on February 28, 2019, under section 6.3.18A of the Transmission System Code (TSC), seeking approval of the allocation of construction costs of the Supply to Essex County Transmission Reinforcement (SECTR) Project between the triggering customer and the network pool (i.e., Ontario ratepayers). In this case, the triggering customer is actually Hydro One itself, in its capacity as a licensed distributor (referred to as Hydro One Distribution in this submission). A Notice of Hearing was issued on May 3, 2019.

In its prior application for leave to construct the SECTR Project[1], Hydro One sought approval of a similar allocation of construction costs between the triggering customer and the network pool.[2] As part of that application, Hydro One filed a report prepared by the Ontario Power Authority (now part of the Independent Electricity System Operator or IESO) that set out the recommended methodology for the purpose of such an allocation of costs between a connecting customer and the network pool. This was a new concept at that time and the OEB's TSC cost responsibility rules did not contemplate recovering any costs associated with a connection asset through the network pool. The OEB therefore decided to initiate a policy consultation process[3] to consider changes to the TSC cost responsibility rules including the Hydro One proposal, which was termed the "proportional benefit" approach. In doing so, the OEB also approved a deferral account pending the outcome of that consultation process.

On December 18, 2018, the OEB issued final TSC amendments that included new sections 6.3.18 and 6.3.18A which set out the rules related to the proportional benefit approach that permitted allocating some costs to the network pool, where the applicant demonstrated that the new connection investment also provided benefits to the network. Those new TSC rules are generally consistent with the proposed approach set out in Hydro One's initial SECTR application. The finalization of those TSC amendments permitted Hydro One to proceed to file the current SECTR application.

OEB staff notes that section 6.3.18 of the TSC requires the applicant to provide supporting evidence from the IESO in any application submitted under section 6.3.18A.[4] The IESO filed the necessary letter on April 26, 2019 (April 26th IESO letter). As noted in

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[1] EB-2013-0421, http://www.rds.oeb.ca/HPECMWebDrawer/Record/423517/File/document
[2] Hydro One Networks received OEB approval in that proceeding to construct the SECTR project.
[3] EB-2016-0003.
[4] Section 6.3.18A states "Where section 6.3.18 applies, the transmitter shall apply to the Board for approval of the attribution of costs between the triggering customer(s) and the network pool. Where the Board approves a different attribution of costs, the transmitter shall recalculate the capital contribution to be made by the triggering customer(s)."

Procedural Order #1, the April 26th IESO letter forms part of the record in this proceeding.[5]

Proportional Benefit Methodology to Allocate Costs

As contemplated by the OEB when the recent revisions to the TSC were made, Hydro One determined the proportional benefit (and the related attribution of costs) based on a notional scenario whereby the network need and triggering customer need are addressed by separate investments to ascertain the proportion each contributes to the aggregate cost of those individual investments. The relative proportions are then applied to the total cost of the actual integrated solution (i.e., SECTR Project) that addresses both needs in order to allocate the costs.[6]

- In the current application, Hydro One estimated that **72.6%** of the benefits will accrue to the triggering load customer (Hydro One Distribution) and **27.4%** of the benefits will accrue to all Ontario ratepayers.
- In its 2013 SECTR application, Hydro One estimated that **77.5%** of the benefits would accrue to the triggering load customers and **22.5%** of the benefits would accrue to all Ontario ratepayers.

The application identifies that the investments to address the network need included upgrading the J3E/J4E circuits to 1,600 amps (from Keith TS to Essex 1 TS) and installing 50 MVAr of reactive support (in the Windsor-Essex area). In the initial EB-2013-0421 application, the estimated cost associated with those two investments was $20.5 million. In the current EB-2019-0120 application, Hydro One used the same estimated cost – $20.5 million – for cost allocation purposes.[7]

In the initial 2013 application, the estimated cost of the investment that would address the customer need was $77.4 million. In Hydro One's current application, a cost of $54.3 million was used for cost allocation purposes. In responding to staff interrogatory #2, Hydro One clarified that the $54.3 million in the application was actually not the final actual cost. Instead, Hydro One indicated it "represented only the actual cost to date" and "some additional costs still remain to be finalized". As a result, Hydro One provided a further final cost estimate for the SECTR project that was $3.2 million higher at $57.5 million.

[5] http://www.rds.oeb.ca/HPECMWebDrawer/Record/640348/File/document
[6] As the OEB explained in the Notice of Proposal to Amend a Code, September 21, 2017 (EB-2016-0003), "The methodology relies on a proxy to estimate the cost to address each need individually, which provides the basis to determine the apportionment" (page 7).
[7] There was a third investment in the initial application. However, as noted in the current application, the IESO has determined that investment was not an avoided cost due to end-of-life (EOL) considerations; i.e., the asset needed to be replaced, regardless of the SECTR project.

In staff interrogatory #2, Hydro One was asked if the $20.5 million related to the investments to meet the network need had been re-estimated and, if not, to provide an updated cost estimate. Hydro One acknowledged that the cost estimate had not been reviewed since the initial application and provided a revised cost estimate of $18.1 million as part of the interrogatory response.

2 STAFF SUBMISSION

Cost Apportionment between Triggering Customer and Network Pool

OEB staff had some concerns with the cost allocation calculation as initially set out in Hydro One's application. However, those concerns have largely been addressed through Hydro One's interrogatory responses. Subject to Hydro One making the necessary adjustments to its approach in the current application based on those interrogatory responses, OEB staff supports Hydro One's proposed approach to allocate the costs between the triggering customer and the network pool (i.e., all ratepayers) as the methodology is generally consistent with the proportional benefit approach now enshrined in section 6.3.18 of the TSC.

One of OEB staff's concerns related to Hydro One's proposal to attribute the costs based on a recent updated cost estimate for the customer solution, while continuing to use an old cost estimate of $20.5 million for the network solution that was developed over five years ago and not reviewed before submitting the current application. The IESO raised a similar concern in its April 26th letter. OEB staff therefore asked Hydro One to provide an updated cost estimate for the network solution in staff interrogatory #2 which was $18.1 million.[8] OEB staff also requested information on other benchmark projects that underpinned that updated cost estimate. Hydro One provided that information.[9] The updated cost estimate (and benchmark project information underpinning it) alleviated this OEB staff concern.

OEB staff does not take issue with Hydro One's selection of the notional "proxy" project that would have addressed the network system need separately (i.e., the upgrade to the J3E/J4E 115 kV circuits and the installation of 50 MVAr of reactive support). That is essentially the same project that was identified as a "proxy" by the Ontario Power

[8] In responding to that interrogatory, Hydro One also identified that the forecast final cost for the SECTR project had been further revised from $54.3 million in the application to $57.5 million.
[9] Hydro One noted "Line projects similar to J3E/J4E (12.2 km) include D10S/D9HS (7.1 km) and D1A/D3A (4.2 km), which cost $6.8M and $5.4M, respectively. Similar projects involving dual capacitor banks include Midhurst TS and Orillia TS, which cost approx. $2.6M each."

Authority (now IESO) in the original SECTR case. OEB staff takes some comfort that a refinement has recently been made based on input from the IESO; that is, to remove an investment from the "proxy" project that the IESO determined was not an avoided cost due to the SECTR project.[10]

OEB staff emphasizes that, in one important respect, this is an exceptional case. Normally, the transmitter is expected to calculate the allocation of costs between the triggering customer(s) and the network pool at the time leave to construct (LTC) is sought in relation to the project. The allocation is based on estimates, and there is no mechanism to true up the estimates to actual costs or to retroactively change the proportional benefit (and related cost attribution) based on revised cost estimates post project approval. Allowing revised estimates after project approval, on an ad hoc basis, would open up the process to gaming (e.g., update only where it shifts more costs to the network pool). OEB staff also notes that decisions of customers are sometimes made based on how costs are allocated and, as the IESO noted in its April 26th letter, introducing new information in the attribution of costs between the network pool and the triggering customer after the project is approved raises questions around the validity of forecast-based decision making. OEB staff notes that, while this is not an issue in this case (since the change is too immaterial to affect any decision), it may be in future cases.

In this case, however, OEB staff agrees with Hydro One that it is appropriate to use the most recent cost estimates for the SECTR project (which is already in service but for which there are still some outstanding costs) and the "proxy" project that would have met the network need. In the SECTR LTC proceeding, the OEB specifically deferred the cost allocation question to a later date, pending the outcome of the broader policy consultation: "the cost allocation matters in respect of the SECTR Project can be dealt with subsequent to the commencement of the project".[11] OEB staff notes it is the OEB's general approach to use the best information available. In the exceptional circumstances of this case, OEB staff submits it would not be appropriate to base the cost allocation on 2013 estimates that we now know to be less accurate. In particular, Hydro One's response to staff interrogatory #1 aligns with the view of OEB staff in noting that "the cost inputs for determining proportional benefits should not normally be updated at this late stage", but also noted that "SECTR is an exceptional case" because some actual costs are already known and represented "the best information available at this time".

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[10] As noted on page 1 of Hydro One's application, the asset needed to be replaced anyway due to end-of-life reasons.
[11] EB-2013-0421, Decision and Order on Phase 1, July 16, 2015, page 10.

OEB staff submits that the latest cost estimates, as reflected in the interrogatory responses ($18.1 million for the network solution and $57.5 million for the customer solution), should be used to determine the proportional benefit, as opposed to the estimates cited in the initial application in this case ($20.5 million and $54.3 million). However, it was not clear from Hydro One's interrogatory responses that Hydro One is also of the view that the updated cost estimates should now form the basis of the actual cost allocation, rather than the amounts initially included in its application. OEB staff is therefore seeking clarification on this matter from Hydro One in its reply submission.

In this case, the difference between using the best available information and the estimates filed in the 2013 LTC application is not material. As shown in Hydro One's response to LPMA interrogatory #3, using the 2013 cost estimates would result in an allocation to the network pool of $12.9 million, whereas using the latest estimates would result in $13.7 million – a difference of $800,000. To place that in perspective, the 2019 revenue requirement for the network pool is about $924 million (i.e., 0.086%).[12]

Cost Apportionment within the Distribution System

In responding to SEC interrogatory #2 (and similar questions from Entegrus and Essex Powerlines Corp.), where SEC asked if Hydro One Distribution expected to allocate any of the costs to any of its embedded distributors or large users by way of a capital contribution, Hydro One appeared to suggest that this matter was limited to the Distribution System Code (DSC) and also stated the question was beyond the scope of this proceeding. Hydro One also noted that the capital contribution requirements in the DSC operate in exactly the same manner regardless of whether section 6.3.18A of the TSC applies or not.

OEB staff notes that the only amounts that need to be formally approved by the OEB in this proceeding is the proportional allocation of costs between the triggering customer – Hydro One Distribution – and the network pool (i.e., all Ontario ratepayers).

However, OEB staff has concerns about Hydro One Distribution's apparent refusal to confirm with its embedded distributors whether or not it will be seeking to recover any SECTR-related costs from them. For example, knowing that could affect how and whether they wish to comment on the proposed allocation between Hydro One Distribution and the network pool -- the focus of this proceeding.

[12] Decision and Rate Order for 2019 Uniform Transmission Rates (EB-2018-0326).

Within that context, OEB staff also does not fully agree that the matter of allocating costs to embedded distributors or large users by way of capital contributions is limited to the DSC or that the capital contribution requirements in the DSC are exactly the same regardless of whether section 6.3.18A of the TSC applies or not. For example, it must be an upstream transmission asset for section 6.3.18A to apply and the determination of a capital contribution differs depending on whether it is an upstream *transmission* asset or a *distribution* asset. The reasons for addressing upstream transmission assets differently in this regard are discussed below.

During the consultation process that culminated in adding the proportional benefit provision (section 6.3.18) to the TSC[13], Hydro One Networks (in its capacity as both a transmitter and distributor) identified a process concern. That concern related to circumstances where embedded distributors and distribution-connected customers are required to provide a capital contribution in relation to an upstream transmission connection investment; specifically, the use of two different economic evaluation methodologies – TSC (Appendix 5) and DSC (Appendix B) – in relation to the same asset, since it would result in different capital contribution outcomes. As such, Hydro One Networks suggested that only the TSC discounted cash flow (DCF) should be used.

The OEB agreed with Hydro One Networks that the same economic evaluation methodology should be used for all capital contribution calculations related to the same upstream transmission asset and that it should be the transmission DCF (in the TSC). The OEB also concluded that the transmitter should carry out all capital contribution calculations on behalf of distributors (e.g., Hydro One Distribution in this instance) at the same time for a number of reasons including the following:

> It would be more efficient to **calculate the amount owed by each distributor – embedded and host – at the same time** relative to a two-step process (whereby the host distributor would do the calculation in relation to embedded distributors after the transmitter does it for the host distributor).[14] [emphasis added]

The OEB therefore amended the TSC by adding section 6.3.20 to clarify that the transmitter is responsible for determining all capital contributions (and subsequent related true-ups) for all beneficiaries including host distributors, embedded distributors,

[13] EB-2016-0003.
[14] Notice of Revised Proposed Amendments to the TSC and the DSC (August 23, 2018, page 9).

etc. where it involves an upstream transmission asset.[15] [16] The OEB also included a related obligation in section 3.6.1 of the DSC for the host distributor (i.e., Hydro One Distribution in this instance) "to request that the transmitter, who owns the connection facility, calculate the capital contribution amount for each beneficiary".

Given the above, if Hydro One Distribution intends to seek a capital contribution from any embedded distributors (or any other large customers), Hydro One Distribution should have informed the transmission side of Hydro One in accordance with section 3.6.1 of the DSC. As noted above, the OEB's intent was for the transmitter "to calculate the amount owed by each distributor – embedded and host – at the same time" and, in doing so, avoid the "two-step process" described by Hydro One in its response to SEC. OEB staff is therefore of the view that if Hydro One Distribution intends to seek any capital contributions from its embedded distributors or other customers (which pursuant to section 6.3.20 of the TSC would be calculated by the transmitter), it should be doing so now. Alternatively, if Hydro One Distribution does not intend to recover any SECTR related costs through a capital contribution, it should say so now rather than continuing to leave the potential impacted parties in a state of uncertainty. OEB staff is also of the view that confirmation of Hydro One Distribution's intent should be provided in Hydro One's reply submission.

OEB staff notes that Hydro One indicated that there was a need to "ease all impacted parties' (e.g., downstream distribution-connected customers) uncertainties regarding financial obligations."[17] OEB staff agrees on the need to do so.

OEB staff also notes that the greenhouse load has continued to grow so significantly beyond expectations that the IESO recently issued a hand-off letter to Hydro One (the transmission business) related to the need for further investment in the Leamington area.[18] This new project will accommodate an additional 400 MW of load (i.e., twice the amount of load meeting capability of the SECTR project). OEB staff notes that there would only be a need for this further investment – essentially SECTR phase 2 – if capacity on the SECTR project will be fully utilized and Hydro One is, in turn, maximizing rate revenues. In addition, the cost of the SECTR project is coming in

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[15] Notice of Amendments to the DSC and the TSC (December 18, 2018, page 5).
[16] Section 6.3.20 of the TSC states *"For the purposes of section 3.6.1 of the Distribution System Code, the transmitter shall, upon the request of a transmission-connected distributor, calculate the capital contribution amount for each distributor and each distribution-connected large load customer … that contributes to the need for a new or modified transmitter-owned connection facility using the methodology and inputs described in Appendix 5 of this Code."*
[17] EB-2019-0120, Application and Evidence, page 2.
[18] http://www.ieso.ca/-/media/Files/IESO/Document-Library/regional-planning/southwest-ontario/Leamington-Transmission-Line-Handoff-Letter-June2019.pdf?la=en

significantly lower than Hydro One initially projected. Before that significant unexpected increase in load and substantial reduction in cost, the estimated capital contributions for the embedded distributors were also relatively minor. For example, Entegrus Powerlines Inc. identified in Entegrus interrogatory #1 that the initially proposed contribution to be collected from them was only about $1 million. OEB staff is therefore hard pressed to understand how any contribution could be required and why Hydro One did not just let its customers know whether they would seek one when it responded to their interrogatories.

In summary on this point, OEB staff submits that the current state of uncertainty about whether Hydro One Distribution will seek to pass on any SECTR related costs to its embedded distributors and other large customers is undesirable. Hydro One appeared to acknowledge that uncertainty needed be addressed as indicated in its statement noted above from the application. Hydro One is encouraged to provide good customer service by clarifying matters in its reply submission.

OEB staff notes that when new section 6.3.18A was proposed, the OEB noted that an adjudicative process was needed "to ensure there is not an over-allocation to the network pool (i.e., all consumers)."[19] Concerns about over-allocation may be especially salient in cases such as this where the transmitter proposing the allocation and the triggering customer affected by the allocation are one and the same company. The OEB did not require that the capital contributions sought by the triggering customer to also be approved by the OEB. But that is not to say that the customers of Hydro One Distribution would have no recourse if Hydro One Distribution in fact asks for a contribution and they do not agree with the amount. The contribution must be calculated by Hydro One in accordance with the DSC and TSC. If a customer disputes the calculation, and is unable to resolve matters through discussions with Hydro One, it could make a complaint to the OEB. The OEB would then investigate with a view to ensuring compliance with the prescribed methodology.

All of which is respectfully submitted.

[19] As the OEB explained in the Notice of Proposal to Amend a Code, September 21, 2017 (EB-2016-0003), "The methodology relies on a proxy to estimate the cost to address each need individually, which provides the basis to determine the apportionment" (page 7).