December 17, 2019

Christine Long
Registrar and Board Secretary
Ontario Energy Board
2300 Yonge Street
P.O. Box 2319
Toronto, Ontario
M4P 1E4

Dear Ms. Walli:

EB-2019-0082 –Hydro One Transmission – 2020-2022 Rates

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

Please feel free to contact me if you have questions.

Yours truly,

Julie E. Girvan

Julie E. Girvan

CC: HON, Regulatory Affairs
All Parties

HYDRO ONE NETWORKS INC. - TRANSMISSION - 2020-2022 RATES

FINAL ARGUMENT OF THE CONSUMERS COUNCIL OF CANADA

EB-2019-0082

INTRODUCTION:

On March 21, 2019, Hydro One Networks Inc. ("HON") filed an Application with the Ontario Energy Board ("OEB") for approval of changes to its transmission revenue requirement effective January 1, 2020. HON is seeking approval of its revenue requirement for a three-year period that has been derived using a Custom Incentive Rate-Setting ("Custom IR") methodology. The Ontario Uniform Transmission Rates will be set on the basis of the HON approved revenue requirements for 2020, 2021 and 2022.

HON's rates were set on a cost of service basis for 2017 and 2018. For 2019 the OEB approved a one-year price cap. This Application represents the first one by HON Transmission for a Custom IR framework.

These are the submissions of the Consumers Council of Canada ("Council") regarding HON's Application and the relief sought. The Council's submissions will follow the general categories as set out in the OEB-Approved Issues List. The Council will not make submissions on all issues, but notes that silence on an issue does not represent an endorsement of HON's proposals. Overall, the Council is not taking issue with many of HON's proposals. The Council's primary concern with HON's Application is the level of capital spending and the impact of that spending on rates.

OVERVIEW AND CONTEXT:

HON's Application is for a three-year Custom IR, which is based on a similar model approved for HON's distribution rates for the period 2018-2022. The specific approvals requested, as set out in HON's Application are the following:

- An approved Revenue Requirement for 2020 of $1.602 billion, not including External and Other Revenue. With these amounts included the 2020 total Rates Revenue Requirement is $1.566 billion.[1]

- The proposed Custom IR model as a framework to set HON's Transmission Revenue Requirement for the period effective January 1, 2021 to December 31, 2022;

- The charge determinants by rate pool over the test period;

- To maintain the Export Transmission Service ("ETS") rate of $1.85/MWh;

- The fees associated with it Wholesale Meter Service;

- The continuation of HON's current regulatory accounts;

- Accounting orders establishing and Earnings Sharing Mechanism ("ESM") Deferral Account and a CCRA True-Up Deferral Account;

- The disposition of regulatory assets of $20 million reflecting principal balances as of December 31, 2018; and

- An effective date of January 1, 2020.[2]

The average transmission rate increase, as set out in HON's Argument in Chief ("AIC") and Exhibit J8.5, in 2020 is 4.1%, of which 3.8% is attributable to declining load. The three-year average annual transmission rate increase is 5.5% or 3.8% without the impact of the declining load. In 2022 the increase is 6.5%. This results in an average bill impact of .3% for both transmission-connected customers and distribution-connected customers, as transmission is a relatively small component of the overall bill.

Despite the relatively small impacts being proposed by HON the relief requested, if granted would result in HON's ability to recover over $4.9 billion in revenue from Ontario's electricity customers. HON is also seeking to spend $3.88 billion in capital over the three-year rate plan period.[3] This level of capital spending is expected to

[1] Ex. J 8.5
[2] Ex. A/T3/S1
[3] Tr. Vol. 1, p. 36

increase beyond the test period. The OEB's review of HON's proposals is critically important for Ontario's electricity customers, particularly as electricity bills are expected to increase beyond 2022. It is imperative from the Council's perspective that the OEB not take a narrow view and simply assess this Application on the basis of the overall bill impacts of HON's proposals for 2020-2022, which are relatively small. The OEB must carefully consider whether this request to recover over $4.8 billion is prudent, cost-effective and represents true value for HON's customers for the services being provided. It is important to note that this is a three-year rate plan and not a five-year plan, which is the normal period for a Custom IR. HON will have an opportunity to rebase in 2023, which has not been the case for other utilities that have proposed a Custom IR plan. Therefore, the risks to HON arising from its rate plan are less than the risks faced by other utilities.

HON's is making its requests in what it views as a period of significant changes with many challenges including:

1. Increasing customer expectations relating to reliability and power quality;

2. Aging infrastructure and deteriorating asset conditions that require increased maintenance and renewal to mitigate risks to public or employee safety and system and customer reliability;

3. Regional infrastructure needs to address system constraints to enable new load growth and to facilitate system access;

4. Increased focus on critical infrastructure protection and associated regulatory compliance, requiring greater system resiliency against climate change impacts, cyber-attacks and threats to physical security; and

5. Mitigating the rate impacts of HON's plan on both its transmission customers and distribution-connected customers through productivity improvements to reduce costs for the benefits of its customers and shareholders.[4]

HON has not quantified the impact of each of these factors on it the proposed revenue requirements for each of the years in the plan term.

It is clear, however, that HON's rate increases over the rate plan term are driven in large measure by its proposed capital spending. Rate base growth is the largest

[4] AIC, p. 5

component of the increases in the revenue requirement[5]. HON's investment decisions, which are set out in its 2020-2024 Transmission System Plan ("TSP"), that forms a large part of the evidentiary record in this proceeding, have been primarily driven by asset condition. In addition, HON has emphasized throughout this proceeding that its customer engagement activities have informed the overall level of investment set out in the TSP. HON has concluded that the result of its enhanced planning process is a TSP that is customer focused, and that reflects investment levels that are in line with "what a majority of customers support"[6].

The Council's concerns with HON's Application and the proposed transmission rates for the years 2020-2022 are set out in our submissions below. The Council's primary concerns with the Application are as follows:

- The Custom IRM formula, as proposed by HON does not include a productivity or stretch factor other than 0%. A fundamental component of incentive regulation is to create incentives for the utility to be productive and find efficiency gains. Customers should be given an upfront benefit from the Custom IR formula. In addition, the proposed C-factor, which effectively passes through the proposed capital spending during the Custom IR term, should include a stretch factor adjustment;

- The overall rate increases, which HON is proposing, are not acceptable as they are significantly above inflation. HON has in each year, since 2015, achieved an actual ROE that has exceeded the OEB approved levels. In 2018 HON's actual ROE was 2.08% over the allowed return[7]. This has been to the benefit of HON's shareholders at the expense of its ratepayers;

- HON is claiming that a majority of its customers support its proposed capital investment levels based on the results of its customer engagement activities. For a number of reasons the Council is of the view that the customer engagement process was flawed and that it is disingenuous for HON to conclude that its investment levels are in line with what "a majority of its customers support";

[5] Ex. A/T3/S1/p. 24
[6] AIC, pp. 6-7
[7] Ex. I-EP-24

- HON has not provided compelling evidence that the increases in capital spending over the rate plan term are justified. In fact, HON has not provided evidence to support spending levels above what is currently in rates;

- HON's actual depreciation expense has been consistently lower than the depreciation expense approved by the OEB and embedded in rates for the period 2015-2018. This has resulted in a significant windfall for HON's shareholders throughout this period;

- The Council is of the view that HON has overstated the level of incremental productivity embedded in its TSP and included in its proposed revenue requirements;

- OM&A levels are lower relative to historical levels, but not relative to 2019. HON has not justified an increase in its 2020 OM&A levels that exceeds inflation;

GENERAL:

OEB Directions:

In its Decision regarding HON's last transmission Application for the years 2017 and 2018 the OEB set out a number of requirements for HON including requirements to improve its processes and to file reports in support of its next rebasing Application. Those directions and HON's response to those directions are set out in detail in Exhibit A/T2/S4.

HON complied with many of those directions in the preparation of this Application, filing a number of key studies and reports. This included the following:

- HON retained Metsco Energy Solutions Inc. ("Metsco") to perform a third-party review of its Asset Condition Assessment ("ACA") process;

- HON took a number of steps to improve its ability to deliver its capital program;

- HON engaged Boston Consulting Group ("BCG") to review its capital investment planning process;

- HON undertook different levels of customer engagement including a 2017 Transmission Customer Engagement Survey conducted by Innovation Research Group ("Innovative");

- HON retained Power System Engineering ("PSE") to undertake benchmarking analyses;

- HON developed new unit cost measures that it proposes to use to monitor the company's ability to become more efficient emphasizing execution and cost performance and reflecting the outcomes of the overall business performance;

- HON updated the Export Transmission Service Rate cost allocation model using the latest available information.[8]

The Council acknowledges that HON has responded to the OEB directions and completed the studies set out above. The Council, however, has a number of concerns with the reports and their value to the OEB in assessing HON's Application. As set out in the sections below, the Council does not accept that the customer engagement work undertaken by Innovative or the work undertaken by BCG support the level of spending proposed by HON through its 2020-2024 TSP, and that proposed for the rate plan period.

Customer Engagement:

It is HON's position that it has undertaken a broad range of customer engagement activities related to the development of its 5-year TSP and that as a result of those activities HON can conclude that "a majority of its customers" support its proposed investment levels[9]. This conclusion is based primarily on the work undertaken by Innovative in 2017.

HON has also set out the other ways it interacts with its customers:

- Customer satisfaction research and surveys;
- Large customer account management;
- The Ontario Grid Control Centre customer operating support group;
- Large customer conferences;

[8] Ex. A/T2/S4/pp. 1-15
[9] AIC, pp. 6-7

- Oversight committees and working groups; and Engagement with Indigenous communities.[10]

The Council urges the OEB to reject HON's claim that the majority of its customers support its investment levels, which are proposed to be $6.6 billion over the TSP planning period – or $3.864 billion for the test year period. It is also a giant leap, from the Council's perspective, to conclude from the Innovative Report that HON has the support from the majority of its customers to invest on average $1.3 billion/year for the rate plan period. The Council's concerns with the customer engagement are as follows:

- HON's customer engagement was concluded before the OEB's 2017-2018 Decision was released, where the OEB focused on costs;

- HON did not update its customer engagement following the release of the Decision although it had ample opportunity to do so;

- Despite a direction from the OEB to engage LDC end-use customers HON chose not to do that – other than asking to LDCs to consider the views of their customers. A majority of LDC customers that participated in the survey indicated that they did not solicit the views of their end-use customers regarding HON's transmission rates[11]:

- 92% of the revenue requirement is paid by customers that were not directly engaged in the survey;

- Cost was not a consideration put to customers that participated in the survey[12];

- Cost has been the primary consideration for customers in all of the Innovative studies undertaken in Ontario to date[13];

- The scenario that was presented to the customers as Scenario C- maintain the current investment levels - was not consistent with what the OEB ultimately approved in the previous case.[14];

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[10] AIC, pp. 16-17
[11] Ex. B/T1/S1 p. 13
[12] Tr. Vol. 1, p. 76
[13] Ex. K6.2, pp. 44-70

- HON failed to inform it customers that the rate increases would be further exacerbated by the decline in load.[15] This may well have impacted the outcome of the Innovative study.

- HON has stated that the results of the customer engagement survey have been re-affirmed by feedback received from subsequent ongoing customer engagement activities, HON has not provided details to support this claim.[16]

- HON never informed its customers that participated in the survey that HON, includes in its rates a ROE of approximately 9%. In addition, HON did not inform its customers that it has overearned above its allowed return since 2015. Had that been disclosed the outcome of the survey would have likely been very different.

HON's proposed capital spending for the rate plan period, from HON's perspective, had been fully endorsed by HON's customers. The Council urges the OEB to reject this conclusion. For the reasons set out above the Council does not accept that HON's customers have endorsed its capital plans for the rate plan period. To conclude that cost is not a consideration for customers is both naïve and irresponsible from the Council's perspective. Cost and reliability continue to be the primary considerations for Ontario electricity consumers, and should be at the forefront of the OEB's decision-making processes.

Effective Date:

HON filed its Application on March 21, 2019, which is over nine months prior to the requested effective date of January 1, 2020. It is HON's position that given the Application was complete and that it conducted itself appropriately and met all of the OEB's established procedural guidelines the January 1, 2020 effective date should be approved[17]. The Council supports the January 1, 2020 effective date on the basis that HON did not take any steps to unnecessarily delay the proceeding and met all of the OEB's prescribed deadlines.

CUSTOM APPLICATION:

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[14] Decision and Order – EN-2016-0160, November 1, 2017, p. 30
[15] Tr. Vol. 6, p. 166
[16] Ex. B/T1/S1/Section 1.3, p. 2
[17] AIC, p. 23

Overview:

HON's Application seeks to establish the revenue requirement for 2020 using a cost of service approach. Under HON's proposals the revenue requirement for 2021 and 2022 will be established using HON's Custom IR formula. That formula mirrors the formula that HON proposed in its last distribution rates proceeding for the period 2018-2022. The OEB approved that formula[18]. The difference in this Application is that HON has tailored the inputs to the transmission industry using benchmarking evidence provided by Power System Engineering ("PSE"). OEB Staff retained Pacific Economics Group LLC ("PEG") to review HON's proposed revenue cap and the evidence filed by PSE.

HON's formula adjusts the revenue requirement for 2021 and 2022 using the following inputs:

- A transmission-specific inflation factor based on a custom weighted 2-factor input price index;

- Two custom productivity factors derived using PSE's benchmarking work and the Total Factor Productivity trend research. This includes a base productivity factor and a stretch factor;

- A capital factor adjustment to reflect the revenue requirement impact of HON's proposed capital spending in each year. [19]

HON has also proposed an Earnings Sharing Mechanism ("ESM") that will share with customers 50% of any earnings that exceed the OEB-approved return on equity ("ROE") by more than 100 basis points in any year of the Custom IR term. In addition, HON has proposed a Capital In-Service Variance Account ("CISVA") to track the difference between the revenue requirement associated with actual and OEB-approved in-service capital additions[20].

Inflation:

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[18] Decision and Order dated March 7, 2019, pp. 20-25
[19] Ex. A/T4/S1/pp. 1-3
[20] Ex. A/T4/S1

The Council supports HON's proposed 2-factor Input Price Index ("IPI") as it is consistent with the methodology the OEB has adopted for electricity distributors.[21] It is also consistent with the inflation factor approved by the OEB with respect to Ontario Power Generation's 5-year price cap plan.[22] Furthermore, it is consistent with what the OEB approved for HON's affiliate, HON Sault St. Marie.[23] The OEB used this approach in setting HON's 2019 revenue requirement as well. The IPI will be updated annually by the OEB and used to set transmission rates for 2021 and 2022.

Productivity and Stretch Factors:

For years the OEB has seen what are effectively academic debates between PEG and PSE regarding the IR proposals included in the Custom IR Applications filed by the larger utilities that the OEB regulates. From the Council's perspective it is difficult to accept that the results of either expert represent the "perfect" solution for setting either a base productivity factor or a stretch factor. Our observations are that the results can differ largely depending upon the data period chosen, the comparator utilities included in any given data set, and the particular design of any model. The Council has argued in the past that although productivity has been either negative or 0 in the past it does not necessarily mean that productivity has to be negative or 0 in the future. The OEB has an obligation to set just and reasonable rates and in doing so, it must consider that incentive regulation regimes should be designed to create efficiencies. HON's proposal for a 0% base productivity factor and a 0% stretch factor does not do this. This is especially relevant to HON, as its transmission business has consistently earned above its allowed ROE.

With respect to productivity HON is proposing an X factor of 0% based on the analysis done by PSE. Based on its total cost benchmarking study PSE concluded that HON is projected to be 32.9% below the benchmark during the 2020-2022 rate plan period. PSE recommended a 0% stretch factor based on those results.

HON's custom industry TFP measure is based on PSE's industry productivity factor recommendation derived from its TFP study. PSE's analysis resulted in a -1.61%

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[21] Report of the Board on Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors dated December 4, 2014, section 2.1
[22] EB-2016-0152
[23] Decision and Order EB-2018-0218, dated June 20, 2019, p. 16

average annual decline in industry-wide TFP for the period 2004-2018.[24] PSE recommended a 0% productivity factor to be consistent with previous OEB direction that it did not want negative productivity factors in an escalation formula.[25]

The PEG analysis recommended a base productivity factor of -.25% with a separate stretch factor of .30%. This results in an overall X-factor of .05%.

The Council submits that the future does not need to be indicative of the past. The OEB should approve a formula that provides incentive for HON to create efficiencies. The Council suggests that the OEB adopt a productivity factor of .3% and a stretch factor of .3% for an overall X-factor of .6%. This will ensure that HON is clearly incented to seek out meaningful efficiencies during the three-year rate plan period.

C- Factor:

The custom capital factor is meant to provide the incremental revenue requirement associated with new capital that is not recovered through the formula including depreciation, ROE, interest and taxes attributable to new capital investment placed in-service each year of the Custom IR term.[26] The calculation of the capital factor for each year is derived from the proposed in-service additions arising from the Transmission System Plan (TSP").

The OEB has approved a C-factor in a previous proceedings including HON's 2018-2022 Custom IR plan for distribution rates. The Council is not opposed to the use of a C-factor, but is of the view that if the OEB simply allows for HON to effectively "pass-through" its proposed in-service additions there is no incentive for HON to look for efficiencies with respect to its capital programs and projects. HON's proposal is to effectively fund all of its capital on a cost of service basis. This is not good for customers during the rate plan term, nor is it good for customers upon rebasing, as HON is not incented to look for sustainable efficiencies in its execution of its proposed capital plan. The Council encourages the OEB to apply a .15% stretch factor to the C-factor as suggested by Dr. Lowry.

Earnings Sharing Mechanism:

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[24] Ex. A/T4/S1/Att. 1, p. 6
[25] AIC, pp. 25-26
[26] AIC, p. 26

HON has proposed an ESM to that will share with customers 50% of any earnings that exceed the OEB-approved return on equity (”ROE”) by more than 100 basis points in any year of the Custom IR term. The Council supports this proposal, as it is consistent with other Custom IR plans approved by the OEB.

Capital In-Service Variance Account:

HON is seeking approval of a Capital In-Service Variance Account (“CISVA”). This account will track the cumulative difference between the OEB approved in–service additions and that actual in-service additions for any capital that is lower than the OEB approved levels[27]. HON has argued that it should be approved as it is identical to the CISVA approved by the OEB in the distribution proceeding and is designed to incent appropriate behaviours throughout the CIR term

The Council sees both benefits and disadvantages with the creation of this account. The intent of the account is to protect customers in the event HON’s actual in–service additions are less than those embedded in the approved revenue requirement. It was proposed in previous years as HON had a consistent track record of capital spending well below the OEB approved levels. However, the account does not guard against HON doing less work for the same amount of money, which in effect, undermines any productivity incentives. It effectively incents HON to spend the full in-service amounts regardless of whether they are doing so in a cost-effective manner and that does not benefit customers upon rebasing.

HON has proposed a 2% dead-band to allow it to retain the benefit of underspending within that band. In addition, it has proposed to exclude from the calculation, any underspending that could be linked to verified productivity savings.[28] It is not clear as to whether the 2% dead-band will benefit consumers given the inability to assess whether HON is completing its capital plan in a cost-effective manner. In addition, it is not clear how HON intends to demonstrate that any underspending is related to productivity and how those benefits will ultimately flow to customers.

The Council accepts the CISVA for the rate plan period. HON should be required in its next rebasing proceeding (2023) to provide a detailed account of the amounts in the account, how they were recorded and to demonstrate specifically how productivity impacts those amounts.

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[27] Ex. A/T3/S1/p. 10
[28] Ex. A/T4/S1/pp. 10-11

PRODUCTIVITY IMPROVEMENT AND PERFORMANCE SCORECARD:

HON, has throughout this proceeding argued that the total revenue requirement and resulting rate impacts have been mitigated by $370 million in savings over the three year rate plan period through defined capital and OM&A initiatives, as well as undefined progressive productivity initiatives for capital[29].

The Council's primary concern with what HON is proposing is that most of the "productivity" being claimed by HON is not incremental, but reflects changes HON has made to its operations, both capital and OM&A, prior to the rate plan period. The Council submits that these changes are not incremental and should not be considered by the OEB as productivity initiatives. The Council urges the OEB, based on the detailed evidence in this proceeding to reject HON's claim that it has embedded $370 million of "productivity" into it revenue requirement forecasts. As supported by the evidence in this proceeding, these are largely operational changes HON has made in years prior to 2020.

HON has characterized its productivity as either savings that result from initiatives that have been undertaken in the past (prior to the test period), or "progressive productivity" which is broken down into defined and undefined. HON is claiming that it has reduced the capital budget by $117 million to reflect its "progressive productivity".[30]

As set out in Exhibit JT 2.28 it is apparent that most of the "productivity" embedded in the budgets are initiatives that have been undertaken prior to the rate plan period. The following are examples of those initiatives:

- Fleet Telematics and Right-Sizing;
- Overtime Reductions;
- Procurement;
- Scheduling Tool
- IT Contract reductions;
- Forestry Initiatives;
- Transmission and Stations[31]

[29] AIC, p. 70
[30] Ex. K6.2, p. 64
[31] Ex. JT2.28

The Council submits that HON has overstated the level of productivity embedded in its proposed revenue requirements for the rate plan period. This highlights the need for a robust IRM formula that has an X-factor greater that 0%. It is also unclear, given the rate plan period is for three years whether any achieved productivity will be sustainable and incorporated into future rates.

TRANSMISSION SYSTEM PLAN:

The level of capital spending embedded in HON's Application is unprecedented. HON is seeking approval of capital spending over the three-year period of $3.89 billion.[32]This represents an increase over the prior three-year period of almost 30%. HON has claimed that as a result of its customer engagement the majority of its customers support this level of spending. As noted above the customer engagement process was fundamentally flawed and should not form the basis of HON's proposed capital spending.

The Council has reviewed the detailed submissions of both the School Energy Coalition ("SEC") and the Association of Major Power Consumers in Ontario ("AMPCO") regarding capital. Both SEC and AMPCO have argued that HON's proposed increases in capital spending should be rejected by the OEB based on the evidence in this proceeding. Clearly, HON has not justified ramping up its capital plan well beyond historical levels. The Council supports these submissions. The Council urges the OEB to reduce HON's proposed capital budgets for the following reasons:

- HON's customer engagement process was flawed and ignored the fact that customers are concerned with cost and the impact capital cost increases have on rates;

- HON's customer engagement process did not consider the perspectives of the customers of the LDCs, even though this was a concern expressed by the OEB in the last Transmission rates proceeding;

- Innovative never told the customers that a 9% ROE is embedded in rates and that for the past four years HON has exceeded its allowed ROE;[33]

[32] Ex. J1.1, p. 6
[33] Ex. I-CCC-14

- The rate increases presented to customers were misleading as they did not include the impact of the reduction in load which has a significant impact on transmission rates;

- HON engaged BCG to review its capital planning process. Given the fact that BCG had been working with HON as part of its Good to Great Program, it is difficult to see how BCG could qualify as an "independent third-party" and undertake an assessment of HON's asset condition and capital planning processes. This leaves the OEB and intervenors without an independent assessment of HON's capital planning processes although this was a requirement by the OEB in the last transmission rates proceeding.[34]

Overall, HON has not presented a capital budget for the rate plan period that has been justified. It was not developed by taking into consideration the most fundamental rate-making concerns for customers which are cost and affordability. In addition, it was developed using a planning process that was not subject to an independent third-party assessment. The Council submits that the OEB should approve a capital budget for HON that is consistent with historical levels. HON is projecting to spend $1.035 billion in 2019[35]. The Council supports setting the budgets for 2020 and beyond by inflating the 2019 budget by the current inflation rate of 1.8%.

OPERATIONS, MAINTENANCE & ADMINISTRATION COSTS:

HON 's proposed OM&A costs for 2020 are $374.1 million. This represents an increase of $17.6 million over the 2019 Bridge year forecast of $356.5. The 2020 levels are less than historical levels.[36] The biggest driver of the increase in OM&A is in the Sustainment category of expenses. HON argues that in 2019 it made a significant one-time reduction to Sustainment OM&A through one-time maintenance reductions, but these reductions are not sustainable over time, as constant deferrals and reduced maintenance cycles give rise to unacceptable safety and reliability risks.

The Council has reviewed the detailed submissions of OEB Staff regarding the proposed level of OM&A for 2020. The Council agrees that an appropriate approach to set the level of OM&A for 2020 is to take the most recent forecast for 2019 and

[34] Eb-2016-0160, Decision and Order, November 1, 2017, p. 18
[35] Ex. J1.1
[36] AIC, p. 85

apply an inflationary adjustment. The Council agrees with OEB Staff that HON has not justified the $17.6 million proposed increase for 2020 based on the following:

- HON has not provided sufficient evidence to demonstrate how, or whether or not, increased capital spending results in OM&A savings;

- In 2016 and 2017 HON's actual OM&A levels were below the OEB Approved amounts by 6.6% and 3.2%respectively, which demonstrates that it may have overstated the OM&A budget for 2020;

- The $214 million OM&A Sustainment budget may be too high, as HON has not sufficiently supported its argument that the deferment of maintenance schedules that occurred in 2019 cannot be carried forward;

- The overall level of HON Transmission OM&A of $680 million (of which 26% is allocated to OM&A appears to be too high;

- HON's evidence is that productivity savings of $22 million are embedded in the 2020 OM&A budget, may these may not in fact be real incremental savings (as discussed in the earlier sections).

Depreciation Expense:

HON's depreciation expense over the rate plan term is $1.5068 billion[37]. The depreciation amounts were derived using a new Depreciation Study undertaken by Foster Associates. The new study has resulted in a reduction in the depreciation expense relative to historical levels.[38]

In each year since 2015, HON's depreciation expense has been well below the OEB approved levels. This pattern is set out in an interrogatory response provided to AMPCO. The variances as set out in that response are as follows[39]:

	OEB Approved	Actual	Variance
2015	$380.9	$359.0	**($21.9)**
2016	$391.1	$373.3	**($17.8)**
2017	$422.6	$394.3	**($28.3)**

[37] Ex. J1.1, Table 2
[38] Ex. F/T6/S1/Attachment 1
[39] Ex. I-AMPCO- 87

2018	$458.4	$411.5	**($46.9)**

This represents a 7% variance on average during that 4-year period. It is important to note during 2017 and 2018 HON's in-service additions were within 1-2% of the approved forecast[40], so the variances are not related to variances in the level of capital going into service.

When asked about the variances during the oral hearing HON indicated that the primary driver was the result of scaling back projects with higher depreciation rates (or not proceeding with them) while proceeding with projects that have a lower depreciation rate. The actual mix of assets was different than that in the forecast.[41]

The Council is concerned with what is evidently a consistent pattern for HON. The windfall to the shareholders has been significant over this period. Customers have funded $114.9 million in rates for an expense that has not been incurred. If this practice were to be maintained, replacing more assets with lower depreciation rates relative to those in the forecast, the shareholders would continue to benefit at the expense of the ratepayers.

The Council proposes that HON's depreciation expense for each year 20120-2022 be reduced by 7%. In the alternative the OEB could require HON to flow through its actual depreciation expense in the CSIVA.

COMPENSATION COSTS:

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

- The Board concludes that it is appropriate to disallow some compensation costs because these costs are substantially above those of other comparable companies and the company has failed to demonstrate that productivity levels offset this situation…The Board will disallow $4 million in each of the test years; this level of adjustment goes some way toward aligning Hydro One's costs with other comparable companies. (May 28, 2008)[42]

[40] Ex. C/T2/S1/p. 2
[41] Tr. Vol. 5, p. 86
[42] OEB Decision - EB-2008-0272, p. 30

- The Board is also concerned that the cost structure of the Company, unless is placed within reasonable boundaries based on appropriate comparisons, will simply continue to rise with successive labour agreements or supply contracts without effective restraint or improvements in efficiency. (December 18, 2018)[43]

- Hydro One 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 the percentage of compensation costs that will be included in the rate paid by Hydro One's customers…While the OEB recognizes that the progress Hydro One has made over the last few years in getting closer to the market median, the OEB does not find that it is fair that ratepayers pay for a 10% premium over the market median. (March 12, 2015)[44]

- The OEB finds that the significant increases in compensation levels for senior executives and for members of the Board of Directors that Hydro One Limited has introduced have not been justified for recovery in OEB regulated rates for transmission services. The OEB is also concerned that Hydro One's progress towards bringing its total compensation levels down to the market median has now reversed…Accordingly, for ratemaking purposes the OM&A envelopes will be reduced by $15 million each year to $397.7 million for 2017 and $394.3 million for 2018 to reflect the unreasonable levels of compensation sought to be recovered from ratepayers. (October 11, 2017)[45]

- The OEB finds that its ongoing concern about HON's compensation costs being higher than comparable companies has not been satisfactorily addressed. The concern has been expressed in almost every OEB decision involving both the distribution and transmission costs of HON for the last 10 years[46].

[43] OEB Decision - EB-2007-0681, p. 13
[44] OEB Decision – EB-2013-0416, p. 24
[45] OEB Decision – EB-2016-0160, pp. 58-59
[46] OEB Decision – EB-2017-0049, p. 110 (March 7, 2019)

- Although the OEB acknowledges that HON attempted to make progress in both the unionized and non-unionized compensation areas its compensation levels remain significantly above the market median. The latest Mercer compensation study, filed by HON on April 20, 2017, concluded that HON is positioned approximately 12% above the market median. In previous years HON's position has ranged from 10% above median in 2013 to 14% in 2016.

- While the OEB understands the limitations associated with the collective agreements, it does not believe that sufficient progress has been made by HON in the last few years to bring its compensation levels closer to market median. In fact, one could argue that the benchmarking results are getting worse (10% above median in 2013 and 12% above median in 2017)

- The OEB will disallow the full $17.5 million premium over market median as there is no compelling reason for the ratepayers to continue to be burdened with this unreasonable compensation level after many years of the OEB finding issue with HON's compensation.[47]

The Council submits that the OEB should continue to be concerned about HON compensation costs as they remain out of market.

With respect to its proposed overall compensation costs HON argues that they are appropriate for the following reasons:

- HON has taken meaningful steps to keep costs as low as reasonably possible, responsive to feedback from the OEB, customers and stakeholders. It has made progress in limiting compensation costs, and actively managing the efficiency and size of its workforce. This included significant steps to reduce pension costs. At the same time, accomplishing the significantly growing work programs and delivering on the important outcomes to which the company is committed required HON to attract, retain and motivate a highly skilled work and performing workforce with appropriate compensation systems. HON's balanced compensation framework achieves these objectives[48].

Despite this, HON's compensation is increasing at a rate higher than inflation. HON's overall 2020 compensation costs were reviewed in HON's most distribution rate

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[47] Ibid, pp. 110-111
[48] AIC, pp. 101-102

application and reduced by the OEB. The benchmarking evidence by Mercer presented in that case is the same evidence that was presented in this case. The Council sees no reason why the same compensation program should be treated differently in this case. HON's compensation costs continue to be out of market, and despite repeated concerns by the OEB, nothing has been by HON to address those concerns. HON is free to compensate its employees as it sees fit, but Ontario ratepayers should not be required to fund compensation costs that are not reasonable. The Council supports adjusting the revenue requirement to bring HON's overall compensation costs to the market median.

HON should be required in its next cost of service rebasing application to demonstrate to the OEB that it is making strides in terms of bringing its compensation levels more in line with its market comparators.

LOAD AND REVENUE FORECAST:

Load Forecast:

The Council supports the submissions of the London Property Management Association with respect to the 2021 and 2022 rate year. LPMA has concluded that there should be no reduction in the load forecast for those two years. This is also consistent with the submissions of OEB Staff.

Other Revenue:

The Council has reviewed the submissions of the London Property Management Association regarding Other Revenue. Given that the external revenues are covered with variance accounts the Council has no concerns regarding these accounts.

EXPORT TRANSMISSION SERVICE RATES:

HON collects the Export Transmission Rate ("ETR") revenues from export transactions as those transactions use HON assets. The revenues are used to offset the overall revenue requirement. The current rate is $1.85/MWh and was the result of a negotiated settlement between HON and intervenors during HON's 2015-2016 transmission proceeding. This rate was first developed by Elenchus Research Associates Inc. and filed as a part of that proceeding. For this proceeding HON updated the Elenchus cost allocation model based on the latest available information and the resulting rate is $1.25/MWh.

HON is proposing to maintain the current rate as it is concerned that a decrease in the rate would adversely affect Ontario consumers by reducing the revenue requirement offset[49]. In addition, HON pointed to deficiencies in the Elenchus cost allocation study. Specifically, HON made the point that the study excluded the allocation of shared capital costs to export customers even though those assets do service export customers. HON also referred to the fact that no review was undertaken regarding how ETS rates are determined in other jurisdictions[50].

The Council supports maintaining the current ETR on the basis that the $1.25 arises from a cost allocation model that is flawed. The Council submits that it would be more appropriate to review the overall design of the rate in HON's next cost of service proceeding, which is expected to be for the 2023-2027 rate plan period. HON should be required to bring forward a robust cost allocation study regarding ETS rates at that time. Other parties will have a full opportunity in that proceeding to test HON's evidence. There was no comprehensive evidence presented in this proceeding to justify a reduction in the ETS.

COSTS:

The Council requests that it be awarded 100% of its reasonably incurred costs related to its participation in this proceeding. Throughout this process the Council has endeavored to be cost-effective and has worked closely with other intervenors.

All of which is respectfully submitted

[49] AIC, p. 121
[50] Tr. Vol. 9, pp. 5-10