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Susan Frank

Vice President and Chief Regulatory Officer
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BY COURIER

July 25, 2008

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

Dear Ms. Walli:

**EB-2007-0681 – Hydro One Networks' 2008 Distribution Rate Application – Undertaking
Response to J2.7**

I have attached 10 copies of the Undertaking response to J2.7. An electronic copy of the undertaking has been filed using the Board's Regulatory Electronic Submission System (RESS) and the proof of successful submission slip is attached.

Sincerely,

ORIGINAL SIGNED BY SUSAN FRANK

Susan Frank

Attach.

c. EB-2007-0681 Intervenors

UNDERTAKING

Undertaking

ANALYSIS TO PROVIDE A SCENARIO EXAMINING THE MOVE TO A SIX-YEAR VEGETATION MANAGEMENT CYCLE FROM AN EIGHT-YEAR CYCLE

Response

Hydro One carried out a financial analysis comparing the incrementally higher costs associated with the immediate transition to a 6-year vegetation management cycle from the 8-year cycle proposed in the Application, taking into account the expected savings resulting from this change.

The steady-state 6-year and 8-year cycle costs and savings are based on the information from the 2008 Vegetation Management Program Review provided as Attachment C to interrogatory response Exh. H, Tab 1, Schedule 14. The analysis consisted of the following simplifying assumptions:

- a) incremental costs to move to a 6 year cycle are \$65 million dollars linearly distributed over the 5 year period from 2008 to 2012,
- b) the incremental costs are placed in a regulatory deferral account and interest improved, and
- c) a rate rider would be put in place to draw down the regulatory deferral account in the amount of \$7 million per year, which is equivalent to the expected savings associated with fully transitioning to a steady state 6-year vegetation management cycle

The results from the financial analysis show that it would take a total of 17 years to clear the regulatory deferral account (5 years of accumulating costs, and 12 years of draw down).

The simplified analysis based on theoretical steady-state cost assumptions provides a rough assessment of the pay back period in moving to a shorter clearing cycle, but it should be noted that this simplified analysis is best-case scenario that does not fully account for the challenges associated with implementing the lower 6 year clearing cycle. These challenges include:

- Increases of 33% (16,677 km vs. 12,500 km) over the proposed plan will stretch existing resources and require that a significant portion of the work be outsourced, i.e., contracted.
- The increase in demand for skilled foresters and contractors is expected to increase costs above what was initially projected.
- Contractors would need to be monitored and quality assurance programs would need to be undertaken using qualified staff. This redirection of staff would reduce overall Hydro One in-house capability and productivity.

- Additional staff would need to be trained for job planning and customer contact activities, and during this training period staff will not be fully productive.
- There is limited time remaining during 2008 for any significant increase in accomplishment from that proposed in the Application.

Given the considerations above, and in particular the current tight labour market in Ontario for skilled foresters and the required redirection and training of staff into new roles, it is Hydro One's opinion that the first step to increasing accomplishments should be focused on achieving 12,500 km of vegetation management in an efficient and cost effective manner before moving to another incremental increase in work that equates to 33% of the current target amount of 12,500 km. This gradual approach will minimize inflationary pressures on the vegetation management program and will allow Hydro One to monitor progress, analyze results and refine the costing models used to set the direction for this program.

There are considerable challenges moving immediately from an 8 year to a 6 year vegetation management cycle, including the need to contract out larger portions of the work due to adequate numbers of internal and hiring hall resources not being available to do the needed work, and the associated costs of doing so. Consequently, Hydro One is recommending the implementation of an 8 year vegetation management cycle as proposed in the current Application. As experience is gained with the adoption of an 8 year cycle and the benefits of a shorter clearing cycle are substantiated, the company will consider proposing the transition to a 6 or 7 year cycle in a future Application to the Board.

Accounting Considerations for Incremental Costs to Transition to 6 Year Cycle

Under generally accepted accounting principles (GAAP), annual vegetation management expenditures are considered to be asset maintenance expenditures and are accordingly treated as operating costs of the relevant period. Such expenditures cannot be treated as line-related capital costs as they do not represent acquisition costs of the line asset, nor can they be considered a betterment as they do not extend the line asset's life over the original specification at the in-service date.

Vegetation management expenditures could be deferred to be matched with expected future savings only through an OEB-approved deferral account. To effectively capitalize such expenditures for financial accounting purposes, there would have to be assurance of eventual recovery of the deferred expenditures (i.e. inclusion in future rates). Such treatment would ensure that the regulatory goal of intergenerational equity was met as expenditures would be matched with benefiting periods.